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PINNACLE BANKSHARES CORPORATION

2013 ANNUAL REPORT

BOARD OF DIRECTORS

Front Row: John L. Waller, John P. Erb (Chairman), Aubrey H. Hall, III, A. Patricia Merryman

Back Row: Robert L. Finch, Jr., C. Bryan Stott, Judson H. Dalton, James E. Burton, IV (Vice Chairman), Michael E. Watson, Carroll E. Shelton

Not Pictured: Thomas F. Hall

SENIOR MANAGEMENT

Front Row: Judith A. Clements, Lucy H. Johnson, Vivian S. Brown

Back Row: Thomas R. Burnett, Jr., Aubrey H. Hall, III (President and CEO), Bryan M. Lemley, William J. Sydnor, II

PINNACLE BANKSHARES CORPORATION
AND SUBSIDIARY

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PINNACLE BANKSHARES CORPORATION
AND SUBSIDIARY

First National Bank Office Locations

ALTAVISTA

MAIN OFFICE
622 Broad Street
Altavista, Virginia 24517
Telephone: (434) 369-3000

VISTA OFFICE
1303 Main Street
Altavista, Virginia 24517
Telephone: (434) 369-3001

LYNCHBURG

AIRPORT OFFICE
14580 Wards Road
Lynchburg, Virginia 24502
Telephone: (434) 237-3788

TIMBERLAKE OFFICE
20865 Timberlake Road
Lynchburg, Virginia 24502
Telephone: (434) 237-7936

OLD FOREST ROAD OFFICE
3309 Old Forest Road
Lynchburg, Virginia 24501
Telephone: (434) 385-4432

FOREST

FOREST OFFICE
14417 Forest Road
Forest, Virginia 24551
Telephone: (434) 534-0451

AMHERST

AMHERST OFFICE
130 South Main Street
Amherst, Virginia 24521
Telephone: (434) 946-7814

RUSTBURG

RUSTBURG OFFICE
1033 Village Highway
Rustburg, Virginia 24588
Telephone: (434) 332-1742

PINNACLE BANKSHARES CORPORATION
AND SUBSIDIARY

Officers of Pinnacle Bankshares Corporation

Aubrey H. Hall, III	President & Chief Executive Officer
Bryan M. Lemley	Secretary, Treasurer & Chief Financial Officer
William J. Sydnor, II	Vice President

Officers and Managers of First National Bank

Aubrey H. Hall, III	President, Chief Executive Officer & Trust Officer
Bryan M. Lemley	Senior Vice President, Cashier & Chief Financial Officer
Lucy H. Johnson	Senior Vice President & Chief Information Officer
William J. Sydnor, II	Senior Vice President & Chief Credit Officer
Judith A. Clements	Senior Vice President & Director of Human Resources
Thomas R. Burnett, Jr.	Senior Vice President & Chief Lending Officer
Vivian S. Brown	Senior Vice President & Branch Administration Officer
Pamela R. Adams	Vice President & Loan Operations Manager
James M. Minear	Vice President & Commercial Officer
Shawn D. Stone	Vice President & Commercial Officer
Daniel R. Wheeler	Vice President & Commercial Officer
Tracie A. Gallahan	Vice President & Mortgage Production Manager
Tony J. Bowling	Vice President & Network Administrator
Cecilia L. Doyle	Vice President & Senior Credit Analyst
John E. Tucker	Vice President & Investment Consultant
Tarry R. Pribble	Vice President & Collection and Recovery Manager
Melissa T. Campbell	Assistant Vice President & Branch Operations Manager
Nancy J. Holt	Assistant Vice President & Branch Manager (Main)
Janet H. Whitehead	Assistant Vice President & Branch Manager (Airport)
M. Amanda Ramsey	Assistant Vice President & Branch Manager (Amherst)
Andria C. Smith	Assistant Vice President & Branch Manager (Rustburg)
Kathleen P. Morgan	Assistant Vice President & Branch Manager (Forest)
Arin L. Brown	Assistant Vice President & Branch Manager (Vista)
Christine A. Hunt	Assistant Vice President & Internal Auditor
Vicki G. Greer	Assistant Vice President & Financial Analyst
Lisa M. Landrum	Assistant Vice President & Dealer Finance Officer
Dianna C. Hamlett	Assistant Vice President, Compliance & Bank Secrecy Act Officer
Anita M. Jones	Assistant Vice President & Loan Production Officer
Romonda F. Davis	Assistant Vice President & E-Commerce Sales Officer
Nickolas R. Gillan	Interim Branch Manager (Timberlake)
Barbara H. Caldwell	Assistant Branch Manager (Main)
Lauren R. Michael	Training Officer
Allison G. Daniels	Loan Quality Control Officer
Ann L. Dalton	Real Estate Loan Portfolio Manager
April A. Morris	Retail Business Development Officer (Main)
Doris N. Trent	Retail Business Development Officer (Vista)
Patricia D. Canada	Retail Business Development Officer (Airport)
Sarah M. Bell	Retail Business Development Officer (Forest)
Cathy C. Simms	Dealer Finance Officer
Lynne H. Barrett	Collection Officer
Shirley B. Brooks	Collection Officer

PINNACLE BANKSHARES CORPORATION

DEAR SHAREHOLDERS,

It is my pleasure to report to you that Pinnacle Bankshares Corporation, the one-bank holding company for First National Bank, materially improved its financial performance during 2013 while strengthening its overall financial condition and continuing to build a solid foundation for the future. Our positive results are directly attributed to the commitment of our employees to provide an "Extraordinary Customer Experience" through adherence to service standards that differentiate our organization from other financial services providers across the Region 2000 marketplace. Their proactive approach to change and gathering business combined with increased visibility and recognition of the First National brand are providing a steady stream of opportunities to expand core banking relationships. Success in this regard directly correlates to Pinnacle's improved bottom line and your enhanced return on investment through share price appreciation and payment of cash dividends.

For 2013 Pinnacle generated net income of $3,017,000, which includes insurance proceeds totaling $1,077,000 that were recognized as noninterest income during the second quarter of the year. The proceeds were received in connection with the rebuild of the Vista Branch Office that was destroyed by fire in April of 2012. This branch, which is located in front of Town & Country Shopping Center in Altavista, was reopened in May of 2013. We are appreciative of the patience demonstrated by our loyal customer base during the rebuild process and pleased to have a new state of the art facility to serve their needs.

"Core" operating net income, exclusive of the insurance proceeds, was $1,940,000 for 2013 representing a 45% increase as compared to 2012. This material improvement comes on the heels of a 26% increase in net income for 2012 and a 55% increase for 2011. Profitability as commonly measured by return on average assets and return on average equity were 0.55% and 6.54%, respectively, excluding the insurance proceeds. While we continue to strive for higher levels of profitability, your Board and Management team are extremely pleased with the pace of the Company's progress.

To a large extent asset quality drove our improved core operating net income as Pinnacle's provision for loan losses substantially declined from $1,177,000 for 2012 to $143,000 for 2013. This reduction of over $1,000,000 in the provision expense was due to the continued decline of the Company's problem loans and net charge-offs. Past due loans decreased during 2013 and credit quality indicators trended in a positive direction. Our loan portfolio continues to be strengthened by enhanced underwriting practices and risk mitigation processes as well as the improved financial condition of our borrowers.

As a result of improved asset quality, the Company's allowance for loan losses as a percentage of total loans decreased to 1.23% as of December 31, 2013 as compared to 1.31% as of the prior year end. However, the allowance's coverage of nonperforming loans increased on a year over year basis and Management views its current level as being sufficient to offset potential future loan losses.

The community banking model is still largely dependent on margin and the ability to maintain a healthy level of net interest income. Pinnacle's net interest income was $11,709,000 for 2013, which represents an increase of $108,000 as compared to 2012. While modest in appearance, 2013's improvement was significant as it follows a decline of $490,000 for the prior year and was achieved despite further year over year net interest margin compression. As with many other banking companies, Pinnacle has been challenged by a declining net interest margin, which fell from 3.54% for 2012 to 3.47% for 2013. However, this trend appears to have been reversed due to a significant decrease in our cost of funds caused by the maturity and re-pricing of longer term time deposits combined with an increase in non-interest bearing deposit accounts and other lower cost core deposits. These two factors led to margin expansion over the second half of the year.

As a percentage of total deposits, higher priced time deposits have declined from 51% as of the end of 2010 to 37% as of the end of 2013. During the same time period non-interest bearing deposits, consisting primarily of business checking accounts, have increased from 10% to 15%. This deposit composition helps drive lower cost of funds and compares favorably to national bank peers.

The growth of our core deposits, specifically checking accounts, is due primarily to the continued popularity of First National's KaChing! consumer checking product and an expanded business checking account lineup. The availability of commercial online banking, business remote deposit capture, ACH services and merchant bankcard processing further enhances our ability to expand our small business relationships. Our clients will have even more options for managing their funds in 2014 with our roll out of a new mobile banking product complete with mobile bill-pay and mobile deposit capture.

Pinnacle's ability to generate substantial noninterest income compared to its asset size continues to be a critical component of overall performance. Net of the insurance proceeds referenced earlier, noninterest income totaled $3,477,000, which was an increase of $34,000 or 1% as compared to 2012. This income category is largely driven by interchange fees associated with check card usage as promoted by KaChing!, overdraft fee income, and continued strong performances by the Bank's Mortgage and Investment divisions. As a percentage of average assets, the Company's noninterest income consistently ranks high as compared to other peer community banks in Virginia.

For 2013 noninterest expense increased $318,000, or 2.7%, compared to 2012, which we consider to be well controlled. The increase was largely driven by salaries and employee benefits due to the addition of several new positions created to manage and mitigate risk as well as rising healthcare costs. Pinnacle also experienced an increase in its retirement plan expense as a result of settlement accounting associated with the retirement of a long term executive officer. However, this expense is forecasted to decline by over $600,000 in 2014 due to contributions, market returns and projected rising interest rates.

Total assets as of December 31, 2013 were $358,967,000, up approximately 3% compared to the end of 2012. The principal components of the Company's assets as of year-end 2013 were $277,758,000 in total loans, $35,457,000 in cash and cash equivalents and $29,125,000 in securities. During 2013 total loans remained relatively flat, increasing less than 1% or $440,000, while securities increased approximately 31% or $6,919,000. The expansion of the securities portfolio increases the Company's ability to pick up yield on excess funds. However, Management is reluctant to expand the portfolio much further, despite only modest loan demand, due to the potential for rising interest rates resulting from an improved economy and a reduction in government stimulus.

Total liabilities as of December 31, 2013 were $326,659,000, which is an increase of approximately 2% as compared to the prior year end. Higher levels of deposits drove the increase as demand deposits increased $9,551,000 or approximately 25% and savings and NOW accounts increased $12,999,000 or approximately 9%. These increases were partially offset by a decrease in time deposits, which declined $15,577,000 or approximately 11% as compared to the balance as of December 31, 2012. As referenced, the increase in checking and savings deposits reflects the focus on the expansion of core deposit relationships in 2013, which has helped lower the Company's cost of funds, decreased its dependency on time deposits and continues to provide relationship expansion opportunities.

Pinnacle's total stockholders' equity as of December 31, 2013 was $32,308,000, representing an increase of $4,219,000 or 15% as compared to December 31, 2012. Improved core earnings, the classification of the insurance proceeds as income and the reclassification of some prepaid expenses as assets drove the marked improvement. Earnings growth without excessive leverage has helped to further strengthen the Company's capital position. Pinnacle and First National Bank remain "well capitalized" per all current regulatory definitions and currently meet the new Basel III capital standards to be fully implemented in 2019.

As a result of the Company's overall improved performance and capital position, your Board and Management Team are extremely pleased that a return has been paid to you in the form of a cash dividend over the last five quarters and that the amount of the cash dividend was increased from $0.05 per share to $0.075 per share during the fourth quarter of 2013. We are also encouraged by the market's recognition that our shares are undervalued, which has been demonstrated by the 82% increase in our share price over the course of 2013 to $15.10 per share. While the trading price of the Company's stock has improved significantly over the last year, your Board and Management Team believe that the stock price still does not fully reflect the true value of your Company. Our recently announced Share Repurchase Program will potentially increase trading volume in the stock, which we believe is in the best interest of our shareholders.

Our strategic plan continues to provide a roadmap for success and I am pleased to share with you that two major initiatives were accomplished during 2013. First, our Future Bank Leaders program was launched during the fall of the year in recognition of the need to develop, retain and prepare employees for future opportunities within the Company. Employees selected for the program participate in a variety of planned activities that include outside training, mentoring, observation and job rotation intended to accelerate their education and knowledge of banking so that they are qualified for expanded roles and responsibilities.

Second, in an effort to become more efficient and productive, First National completed a lengthy and extensive evaluation of its information technology environment that culminated with the execution of a long term contract with Fiserv, our core system provider. The contract expands the services provided to the Bank and includes many new applications and platforms. Time savings achieved from streamlined processes will be utilized to focus on customer delivery channels, service and efficient technology usage. Lucy H. Johnson, Senior Vice President and Chief Information Officer, is to be commended for her hard work and efforts to move forward this critical initiative.

In closing, your Board and Management Team recognize that there is no substitute for hard work, dedication and commitment to well devised plans and processes focused on improved performance, regardless of the industry. We operate in a time where only the strong survive and there is no room for complacency. Vision is critical; however, you cannot overlook the basic building blocks and steps required to achieve objectives. As always, we remain committed to the development and execution of strategies to further improve Pinnacle's performance and enhance returns while operating within the parameters of what is considered safe and sound banking practices.

To hear more about the performance and direction of Pinnacle Bankshares Corporation, please plan to attend our Annual Meeting of Shareholders to be held at **11:00 a.m., Tuesday, April 8, 2014** in the Fellowship Hall of Altavista Presbyterian Church, 707 Broad Street, Altavista, Virginia. We are hopeful that you will be able to join us for this occasion.

Thank you for your support, confidence and the opportunity to serve your interests as President and Chief Executive Officer of Pinnacle Bankshares Corporation.

Sincerely,

Aubrey H. Hall, III

Aubrey H. Hall, III "Todd"
President & Chief Executive Officer

PINNACLE BANKSHARES CORPORATION
AND SUBSIDIARY

Selected Consolidated Financial Information
(In thousands, except ratios, share and per share data)

		Years ended December 31,				
		2013	2012	2011	2010	2009
Income Statement Data:						
Net interest income	$	11,709	11,601	12,091	10,776	10,004
Provision for loan losses		143	1,177	2,227	1,878	1,530
Noninterest income		4,554	3,443	3,253	3,134	3,148
Noninterest expense		12,227	11,910	11,544	11,037	11,171
Income tax expense		875	619	510	308	100
Net income		3,018	1,338	1,063	687	351
Per Share Data:						
Basic net income	$	1.99	0.89	0.71	0.46	0.24
Diluted net income		1.98	0.89	0.71	0.46	0.24
Cash dividends		0.225	0.05	0.00	0.05	0.10
Book value		20.09	18.63	18.01	17.71	17.41
Weighted-Average Shares Outstanding:						
Basic		1,512,545	1,503,952	1,496,260	1,492,137	1,485,089
Diluted		1,523,105	1,503,952	1,496,260	1,492,137	1,485,089
Balance Sheet Data:						
Assets	$	358,967	348,694	342,484	337,113	332,210
Loans, net		274,349	273,672	267,123	265,030	265,904
Securities		29,125	22,206	24,769	26,517	20,156
Cash and cash equivalents		35,457	35,790	37,547	32,533	32,060
Deposits		322,130	315,157	310,393	306,954	302,119
Stockholders' equity		32,308	28,089	26,947	26,482	25,851
Performance Ratios:						
Return on average assets		0.85%	0.39%	0.31%	0.21%	0.11%
Return on average equity		10.11%	4.83%	3.95%	2.62%	1.40%
Dividend payout		11.30%	5.61%	0.00%	10.92%	41.88%
Asset Quality Ratios:						
Allowance for loan losses to total loans, net of unearned income and fees		1.23%	1.31%	1.48%	1.50%	1.38%
Net charge-offs to average loans, net of unearned income and fees		0.12%	0.57%	0.84%	0.59%	0.65%
Capital Ratios:						
Leverage		8.98%	8.49%	8.12%	7.74%	8.04%
Risk-based:						
Tier 1 capital		10.92%	10.15%	9.99%	9.36%	9.50%
Total capital		12.10%	11.39%	11.24%	10.61%	10.75%
Average equity to average assets		8.35%	8.04%	7.93%	7.88%	7.69%

Results of Operations

(in thousands, except ratios, share and per share data)

Cautionary Statement Regarding Forward-Looking Statements

The following discussion is qualified in its entirety by the more detailed information and the consolidated financial statements and accompanying notes appearing elsewhere in this Annual Report. In addition to the historical information contained herein, this Annual Report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements, which are not statements of historical fact and are based on certain assumptions and describe future plans, strategies, and expectations of management, are generally identifiable by use of words such as "believe," "expect," "intend," "anticipate," "estimate," "project," "may," "will" or similar expressions. These forward-looking statements may include, but are not limited to, statements relating to future reporting obligations, anticipated future financial performance, impairment of goodwill, funding sources including cash generated by banking operations, loan portfolio composition, trends in asset quality and strategies to address nonperforming assets and nonaccrual loans, adequacy of the allowance for loan losses and future provisions for loan losses, securities portfolio composition and future performance, interest rate environments, deposit insurance assessments, and strategic business initiatives.

Although we believe our plans, intentions and expectations reflected in these forward-looking statements are reasonable, we can give no assurance that these plans, intentions, or expectations will be achieved. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain, and actual results, performance or achievements could differ materially from those contemplated. Factors that could have a material adverse effect on our operations and future prospects include, but are not limited to, changes in: the effectiveness of management's efforts to improve asset quality and control operating expenses; the quality, composition and growth of the loan and investment portfolios; interest rates; decrease in net interest margin; the continuation of our common stock trading below book value; declining collateral values, especially in the real estate market; general economic conditions, including stagnation in general business and economic conditions and in the financial markets; unemployment levels; the legislative/regulatory climate, including the impact of any policies or programs implemented pursuant to the Emergency Economic Stabilization Act of 2008 (the EESA), the American Recovery and Reinvestment Act of 2009 (the ARRA), the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) or other laws; monetary and fiscal policies of the U.S. government, including policies of the U.S. Treasury and the Board of Governors of the Federal Reserve System; demand for loan products; deposit flows; competition; demand for financial services in our market area; regulatory compliance costs; accounting principles, policies and guidelines; and an increase in shareholders that would require the Company to be subject to the reporting obligations of the Securities Exchange Act of 1934, as amended. These risks and uncertainties should be considered in evaluating forward-looking statements contained herein. We base our forward-looking statements on management's beliefs and assumptions based on information available as of the date of this report. You should not place undue reliance on such statements, because the assumptions, beliefs, expectations and projections about future events on which they are based may, and often do, differ materially from actual results. We undertake no obligation to update any forward-looking statement to reflect developments occurring after the statement is made.

Company Overview

Pinnacle Bankshares Corporation, a Virginia corporation ("Bankshares"), was organized in 1997 and is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. Bankshares is headquartered in Altavista, Virginia. Bankshares conducts all of its business activities through the branch offices of its wholly owned subsidiary bank, First National Bank (the "Bank"). Bankshares exists primarily for the purpose of holding the stock of its subsidiary, the Bank, and of such other subsidiaries as it may acquire or establish.

First National Bank was organized in 1908 and currently maintains a total of eight offices to serve its customers. The Main Office and Vista Branch are located in the Town of Altavista, the Airport Branch, Timberlake Branch and Rustburg Branch in Campbell County, the Old Forest Road Branch in the City of Lynchburg, the Forest Branch in Bedford County and the Amherst Branch in the Town of Amherst. The Bank also maintains an administrative and training facility in the Wyndhurst section of the City of Lynchburg.

A total of one-hundred seven full and part-time staff members serve the Bank's customers.

With an emphasis on personal service, the Bank today offers a broad range of commercial and retail banking products and services including checking, savings and time deposits, individual retirement accounts, merchant bankcard processing, residential and commercial mortgages, home equity loans, consumer installment loans, agricultural loans, investment loans, small business loans, commercial lines of credit and letters of credit. The Bank also offers a full range of investment, insurance and annuity products through its association with Infinex Investments, Inc. and Banker's Insurance, LLC. The Bank has two wholly-owned subsidiaries: FNB Property Corp., which holds title to future Bank premises real estate as needed; and First Properties, Inc., which holds title to other real estate owned acquired through foreclosures.

Results of Operations

The Company had net income of $3,017 for the year ended December 31, 2013, compared to net income of $1,338 for the year ended December 31, 2012, an increase of 125.49%. The Company's net income increased due in large part to insurance proceeds totaling $1,077 that were recognized as noninterest income during the second quarter of 2013. The proceeds were received in connection with the rebuild of the Vista Branch Office that was destroyed by fire in April of 2012. Exclusive of the insurance proceeds, net income was $1,940 for the year ended December 31, 2013, an increase of 44.99% over 2012 net income. This increase in net income was driven mainly by a $1,034, or 87.85%, decrease in provision for loan losses as asset quality improved throughout the year and a $782, or 19.69%, decrease in interest expense as cost of funds decreased 31 basis points in 2013 when compared to 2012. Noninterest income exclusive of insurance proceeds increased $34, or 0.99% helped by increases in service charges. These positive factors that contributed to the increase in net income were partially offset by a $674, or 4.33%, decrease in interest income as the yield on earning assets decreased 34 basis points and a $318, or 2.67% increase in noninterest expense primarily due to a $453, or 7.39% increase in salaries and employee benefits driven by salaries for new hires and a $173 increase in defined benefit plan expense in 2013. This increase was due mainly to settlement accounting rules associated with the retirement of a long term executive officer. However, this expense is forecasted to decline by over $600,000 in 2014 due to contributions, market returns and projected rising interest rates. This defined benefit plan expense is expected to be only $11 in 2014.

Management expects continued improvement in net income in 2014 as we expect continued enhancement in asset quality. We also expect the Company's net interest margin to increase in 2014 as long-term time deposits continue to mature and reprice. We also expect an increase in noninterest income exclusive of insurance proceeds in 2014 with the additional sales staff. Finally, we expect a decrease in noninterest expense in 2014 due mainly to a large decrease in our defined benefit plan expense as mentioned before.

Profitability as measured by the Company's return on average assets (ROA) was 0.85% in 2013, compared to 0.39% in 2012. Return on average equity (ROE), was 10.11% for 2013, compared to 4.83% for 2012.

Total assets as of December 31, 2013 were $358,967, up 2.95% from $348,694 as of December 31, 2012. The principal components of the Company's assets at the end of the year were $35,457 in cash and cash equivalents, $29,125 in securities and $274,349 in net loans. During the year ended December 31, 2013, gross loans increased 0.16% or $440. The Company's lending activities are a principal source of income. Securities increased in 2013 to invest cash as competition and higher credit standards made it challenging to materially increase the loan portfolio.

Total liabilities as of December 31, 2013 were $326,659, up 1.89% from $320,605 as of December 31, 2012, due to an increase in total deposits of $6,973 or 2.21%, to $322,130 as of December 31, 2013 from $315,157 as of December 31, 2012. Noninterest-bearing demand deposits increased $9,551 or 25.16% and represented 14.75% of total deposits as of December 31, 2013, compared to 12.04% as of December 31, 2012. Savings and NOW accounts increased $12,999 or 9.21% and represented 47.86% of total deposits as of December 31, 2013, compared to 44.79% as of December 31, 2012. Time deposits decreased $15,577 or 11.45% and represented 37.39% of total deposits as of December 31, 2013, compared to 43.16% as of December 31, 2012. The Company's deposits are provided by individuals and businesses located within the communities served. The Company had no brokered deposits as of December 31, 2013 and December 31, 2012.

Total stockholders' equity as of December 31, 2013 was $32,308, including $26,920 in retained earnings. as of December 31, 2012, stockholders' equity totaled $28,089, including $24,244 in retained earnings. The increase in stockholders' equity resulted from the Company's net income of $3,017 and an improvement in other accumulated comprehensive loss due a large decrease in unrealized losses of our defined benefit plan obligations.

Net Interest Income. The net interest spread decreased to 3.28% for the year ended December 31, 2013 from 3.31% for the year ended December 31, 2012. Yield on earning assets was 4.41% and cost of funds was 1.13% for the year ended December 31, 2013 as compared to a yield on earning assets of 4.75% and a cost of funds of 1.44% for the year ended December 31, 2012. The net interest margin decreased to 3.47% for the year ended December 31, 2013 from 3.54% for the year ended December 31, 2012 as the cost to funds earning assets was 0.94% for the year ended December 31, 2013 as compared to the cost to funds earnings assets of 1.20% for the year ended December 31, 2012. Net interest income was $11,709 for the year ended December 31, 2013, compared to $11,601 for the year ended December 31, 2012, and is attributable to interest income from loans, federal funds sold and securities exceeding the cost associated with interest paid on deposits and other borrowings. In 2013, the Company's loans repriced at lower rates more rapidly than did its deposits in the low interest rate environment, causing the Company's interest rate spread to decrease, although a 9 basis point improvement was realized in the second half of 2013. The Bank's cost of funds rate on interest-bearing liabilities in 2013 was 7 basis points lower compared to 2012, but improved by 7 basis points in the second half of 2013.

Provision for Loan Losses. The provisions for loan losses for the years ended December 31, 2013 and 2012 and 2011 were $143, $1,177 an $2,227, respectively. The provision for loan losses was much improved in 2013 as asset quality was greatly improved and has been on the steady incline since 2011, as the Company continues to recover from credit quality weaknesses that started in 2008 that were due to poor economic conditions, declining collateral values and the increased risk of some customer's inability to service their loans due to job losses. The provision for loan losses decreased 87.85% from 2012 to 2013 as criticized and classified loans and loan chargeoffs decreased due to the success of an aggressive asset quality improvement plan implemented in 2011 that has led to better loan quality. The Company saw an improvement in its nonperforming loans to total loans from 1.09% on December 31, 2012 to 0.93% on December 31, 2013. Nonperforming loans were $2,586 as of December 31, 2013 and $3,014 as of December 31, 2012. The Company expects continued improvement in its loan portfolio in 2014 and is working to minimize its losses from non-accrual and past due loans.

Noninterest Income. Total noninterest income for the year ended December 31, 2013 increased $1,111, or 32.27%, to $4,554 from $3,443 in 2012 mainly due to insurance proceeds of $1,077 received in connection with the rebuild of the Vista Branch Office that was destroyed by fire. The Company's principal source of noninterest income is service charges and fees on deposit accounts, particularly transaction accounts, fees on sales of mortgage loans, and commissions and fees from investment, insurance, annuity and other bank products. Noninterest income exclusive of insurance proceeds increased $34, or 0.99% to $3,477. The increase in 2013 is primarily attributable to a $137, or 9.26% increase in service charges on deposit accounts due to increases in transactional accounts. This increase was partially offset by an $85, or 13.54% decrease in mortgage loan fees and a $30, or 12.50% decrease in service charges on loan accounts.

Noninterest Expense. Total noninterest expense for the year ended December 31, 2013 increased $318, or 2.67%, to $12,228 from $11,910 in 2012. The increase in noninterest expense is primarily due to a $453, or 7.39%, increase in salary and employee benefits as defined benefit plan expense increased $173, or 37.67% and salaries and commissions increased $181, or 3.82% increase. Occupancy expense and furniture and equipment expense increase by $36 and $41 respectively due to depreciation and other expenses associated with the Vista Branch Office rebuild. These increases were offset by a decrease of $23, or 9.62% in office supplies and printing and by a $36, or 12.34% decrease in FDIC insurance premiums. Other operating expenses also decreased by $160 or 5.21% due mainly to a $127, or 25.20% decrease in other losses due to increased asset quality.

Income Tax Expense. Applicable income taxes on 2013 earnings amounted to $875, resulting in an effective tax rate of 22.48% compared to $619, and an effective tax rate of 31.63%, in 2012. The effective tax rate for 2013 is a function of the effects of the Vista Branch Office insurance proceeds, interest earned on tax-exempt securities and income earned from bank-owned life insurance.

Investment Portfolio

Investment securities available-for-sale as of December 31, 2013 totaled $23,406, an increase of $8,160, or 53.52% from $15,246 as of December 31, 2012. Investment securities held-to-maturity decreased to $5,719 as of December 31, 2013 from $6,960 as of December 31, 2012, a decrease of $1,241 or 17.83%. Available-for-sale securities increased in 2013 as cash was invested in mainly federal agency bonds as deposits increased and loan demand was minimal. Held-to-maturity securities decreased in 2013 as some of the Company's municipal portfolio bonds matured or were called.

Loan Portfolio

The Company's net loans were $274,349 as of December 31, 2013, an increase of $677, or 0.25%, from $273,672 as of December 31, 2012. This increase resulted primarily from a small increase in consumer loan originations during 2013. The Company's ratio of net loans to total deposits was 85.17% as of December 31, 2013 compared to 86.84% as of December 31, 2012.

Bank Premises and Equipment

Bank premises and equipment increased $985, or 15.60% in 2013 due to the Vista Branch Office rebuild, and was partially offset by normal depreciation. The Company is leasing the Timberlake and Amherst branch facilities. The Company also leases a building in the Wyndhurst section of Lynchburg for administrative and training purposes.

Deposits

Average deposits were $324,064 for the year ended December 31, 2013, an increase of $12,259 or 3.93% from $311,805 of average deposits for the year ended December 31, 2012. As of December 31, 2013, total deposits were $322,130 representing an increase of $6,973, or 2.21%, from $315,157 in total deposits as of December 31, 2012. The change in deposits during 2013 was primarily due to increased deposit balances in previously existing deposit accounts, new deposit accounts opened as a result of new banking relationships, growth at the Company's branch locations and competitive pricing of the Company's products and services.

Capital Resources

The Company's financial position as of December 31, 2013 reflects liquidity and capital levels currently adequate to fund anticipated funding needs and budgeted growth of the Company. Capital ratios are in excess of required regulatory minimums for a "well-capitalized" institution. The assessment of capital adequacy depends on a number of factors such as asset quality, liquidity, earnings performance, and changing competitive conditions and economic forces. The adequacy of the Company's capital is reviewed by management on an ongoing basis. Management seeks to maintain a capital structure that will assure an adequate level of capital to support anticipated asset growth and to absorb potential losses.

The primary indicators relied on by bank regulators in measuring the capital position are the Tier 1 capital, total risk-based capital and leverage ratios. Tier 1 capital consists generally of common and qualifying preferred stockholders' equity less goodwill. Total capital generally consists of Tier 1 capital, qualifying subordinated debt and a portion of the allowance for loan losses. Risk-based capital ratios are calculated with reference to risk-weighted assets. The Company's Tier 1 capital ratio was 10.92% as of December 31, 2013 and 10.15% as of December 31, 2012. The total capital ratio was 12.10% as of December 31, 2013 and 11.39% as of December 31, 2012.

These ratios exceed the mandated minimum requirements of 4% and 8%, respectively. As of December 31, 2013 and 2012, the Company and Bank met all regulatory capital ratio requirements and were considered "well capitalized" in accordance with the Federal Deposit Insurance Corporation Improvement Act.

Stockholders' equity was $32,308 as of December 31, 2013 compared to $28,089 as of December 31, 2012.

The leverage ratio consists of Tier 1 capital divided by quarterly average assets. as of December 31, 2013, the Company's leverage ratio was 8.98% compared to 8.49% as of December 31, 2012. Each of these leverage ratios exceeds the required minimum leverage ratio of 4%. The dividend payout ratio was 11.30% and 5.61% in 2013 and 2012, respectively, with the increase due to a $0.225 per share dividend paid in 2013 as compared to the $0.05 per share dividend paid in 2012.

PINNACLE BANKSHARES CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2013 and 2012
(In thousands of dollars, except share data)
(Audited)

Assets	**2013**	**2012**
Cash and cash equivalents (note 2):		
Cash and due from banks	$ 35,457	$ 35,790
Securities (note 3):		
Available-for-sale, at fair value	23,406	15,246
Held-to-maturity, at amortized cost	5,719	6,960
Federal Reserve Bank stock, at cost (note 1(d))	142	140
Federal Home Loan Bank stock, at cost (note 1(d))	418	513
Loans, net (notes 4, 9 and 11)	274,349	273,672
Bank premises and equipment, net (note 5)	7,298	6,313
Accrued interest receivable	978	993
Prepaid FDIC Insurance	-	703
Bank owned life insurance	3,113	3,017
Goodwill	539	539
Other real estate owned	1,297	2,393
Other assets (notes 7 and 8)	6,251	2,415
Total assets	$ 358,967	$ 348,694
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits (note 6):		
Demand	$ 47,506	$ 37,955
Savings and NOW accounts	154,166	141,167
Time	120,458	136,035
Total deposits	322,130	315,157
Note payable under line of credit (note 1(e))	1,630	1,900
Accrued interest payable	223	398
Other liabilities (note 7)	2,676	3,150
Total liabilities	326,659	320,605
Stockholders' equity (notes 7, 12 and 15):		
Common stock, $3 par value. Authorized 3,000,000 shares, issued and outstanding 1,515,007 shares in 2013 and 1,507,589 shares in 2012	$ 4,507	$ 4,492
Capital surplus	1,035	987
Retained earnings	26,920	24,244
Accumulated other comprehensive loss, net	(154)	(1,634)
Total stockholders' equity	32,308	28,089
Commitments, contingencies and other matters (notes 9, 10 and 12)		
Total liabilities and stockholders' equity	$ 358,967	$ 348,694

See accompanying notes to consolidated financial statements.

PINNACLE BANKSHARES CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2013 and 2012
(In thousands of dollars, except per share data)
(Audited)

		2013		2012
Interest income:				
Interest and fees on loans	$	14,271	$	14,904
Interest on securities:				
U.S. Government agencies		278		304
Corporate		-		-
States and political subdivisions (taxable)		75		91
States and political subdivisions (tax-exempt)		160		172
Other		112		100
Interest on federal funds sold		3		2
Total interest income		14,899		15,573
Interest expense:				
Interest on deposits:				
Savings and NOW accounts		491		585
Time - under $100,000		1,637		2,073
Time - $100,000 and over		1,062		1,314
Total interest expense		3,190		3,972
Net interest income		11,709		11,601
Provision for loan losses and unfunded commitments (note 4)		143		1,177
Net interest income after provision for loan losses		11,566		10,424
Noninterest income:				
Service charges on deposit accounts		1,617		1,480
Commissions and fees		617		621
Mortgage loan fees		543		628
Service charges on loan accounts		210		240
Insurance proceeds		1,077		-
Other operating income		490		474
Total noninterest income		4,554		3,443
Noninterest expense:				
Salaries and employee benefits (note 7)		6,580		6,127
Occupancy expense		753		717
Furniture and equipment expense		1,062		1,021
Office supplies and printing		216		239
Federal deposit insurance premiums		270		308
Capital stock tax		242		236
Advertising expense		193		190
Other operating expenses		2,912		3,072
Total noninterest expense		12,228		11,910
Income before income tax expense		3,892		1,957
Income tax expense (note 8)		875		619
Net income	$	3,017	$	1,338
Basic net income per share (note 1(q))	$	1.99	$	0.89
Diluted net income per share (note1(q))	$	1.98	$	0.89

See accompanying notes to consolidated financial statements.

PINNACLE BANKSHARES CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2013 and 2012
(In thousands of dollars)
(Audited)

	2013	2012
Net income	$ 3,017	$ 1,338
Other comprehensive income, net of related income taxes:		
Unrealized gains (losses) on availabile-for-sale securities		
Before tax	(552)	115
Income tax (expense) benefit	189	(39)
Changes in plan assets and benefit obligation of defined benefit pension plan		
Before tax	2,794	(425)
Income tax (expense) benefit	(951)	145
Comprehensive income	$ 4,497	$ 1,134

See accompanying notes to consolidated financial statements.

PINNACLE BANKSHARES CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years ended December 31, 2013 and 2012
(In thousands of dollars, except share and per share data)
(Audited)

	Common Stock		Capital	Retained	Accumulated Other Comprehensive	
	Shares	Par Value	Surplus	Earnings	Income (Loss)	Total
Balances, December 31, 2011	1,496,589	$ 4,473	$ 923	$ 22,981	$ (1,430)	$ 26,947
Net income				1,338		1,338
Other Comprehensive Income					(204)	(204)
Issuance of restricted stock and related expense	11,000	19	38			57
Stock-based compensation expense			26			26
Cash dividends declared by Bankshares ($0.05 per share)				(75)		(75)
Balances, December 31, 2012	1,507,589	$ 4,492	$ 987	$ 24,244	$ (1,634)	$ 28,089
Net income				3,017		3,017
Other Comprehensive Income					1,480	1,480
Issuance of restricted stock and related expense	10,000	15	39			54
Stock-based compensation expense			9			9
Restricted Stock for tax purpose	(2,496)					
Paid out owners of partial shares (dividend reinvestment plan)	(86)					
Cash dividends declared by Bankshares ($0.225 per share)				(341)		(341)
Balances, December 31, 2013	1,515,007	$ 4,507	$ 1,035	$ 26,920	$ (154)	$ 32,308

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2013 and 2012
(In thousands of dollars)
(Audited)

	2013	2012
Cash flows from operating activities:		
Net income	$ 3,017	$ 1,338
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of bank premises and equipment	488	492
Accretion of unearned fees, net	20	11
Net amortization of premiums and discounts on securities	74	65
Provision for loan losses	143	1,168
Provision for deferred income taxes	(80)	26
Accrual of stock option vesting	63	83
Increase in cash value of life insurance	(96)	(17)
Net decrease (increase) in:		
Accrued interest receivable	15	16
Prepaid FDIC insurance	703	400
Other assets	(4,545)	85
Net increase (decrease) in:		
Accrued interest payable	(175)	(21)
Other liabilities	2,319	1
Net cash provided by operating activities	1,946	3,647
Cash flows from investing activities:		
Purchases of held-to-maturity securities	(513)	(1,516)
Purchases of available-for-sale securities	(15,014)	(14,005)
Proceeds from maturities and calls of held-to-maturity securities	1,705	500
Proceeds from maturities and calls of available-for-sale securities	6,102	17,429
Proceeds from paydowns and maturities of available-for-sale mortgage-backed securities	176	205
Sale of Federal Home Loan Bank stock	95	15
Purchase of Federal Reserve Stock	(2)	(3)
Net decrease (increase) in loans made to customers	282	(9,349)
Purchases of bank premises and equipment	(1,473)	(369)
Puchase of bank owned life insurance	-	(3,000)
Net cash used in investing activities	(8,642)	(10,093)
Cash flows from financing activities:		
Net increase in demand, savings and NOW deposits	22,550	13,189
Net decrease in time deposits	(15,576)	(8,426)
Net proceeds from insurance company for branch rebuild	-	101
Repayment of line of credit	(270)	(100)
Cash dividends paid	(341)	(75)
Net cash provided by financing activities	6,363	4,689
Net decrease in cash and cash equivalents	(333)	(1,757)
Cash and cash equivalents, beginning of year	35,790	37,547
Cash and cash equivalents, end of year	$ 35,457	$ 35,790
Supplemental disclosure of cash flows information		
Cash paid during the year for:		
Income taxes	$ 850	$ 489
Interest	3,365	3,999
Supplemental schedule of noncash investing and financing activities:		
Transfer from loans to repossessed properties	$ (26)	$ (127)
Loans charged against the allowance for loan losses	621	2,051
Unrealized gains (losses) on available-for-sale securities	(551)	115
Defined benefit plan adjustment per ASC topic *Compensation-Retirement Benefits*	2,794	(424)

See accompanying notes to consolidated financial statements.

(1) Summary of Significant Accounting Policies and Practices

Pinnacle Bankshares Corporation, a Virginia corporation ("Bankshares"), was organized in 1997 and is registered as a bank holding company under the Bank Holding Company Act of 1956, as amended. Bankshares is headquartered in Altavista, Virginia. Bankshares conducts all of its business activities through the branch offices of its wholly owned subsidiary bank, First National Bank (the Bank). Bankshares exists primarily for the purpose of holding the stock of its subsidiary, the Bank, and of such other subsidiaries as it may acquire or establish. The Company has a single reportable segment for purposes of segment reporting.

The accounting and reporting policies of Bankshares and its wholly owned subsidiary (collectively, the "Company"), conform to generally accepted accounting principles in the United States of America ("GAAP") and general practices within the banking industry. The following is a summary of the more significant accounting policies and practices:

(a) Consolidation

The consolidated financial statements include the accounts of Bankshares and the Bank. All material intercompany balances and transactions have been eliminated.

(b) Use of Estimates

In preparing the consolidated financial statements in accordance with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the consolidated balance sheets and revenues and expenses for the years ended December 31, 2013 and 2012. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses and fair value of investments.

(c) Securities

The Company classifies its securities in three categories: (1) debt securities that the Company has the positive intent and ability to hold to maturity are classified as "held-to-maturity securities" and reported at amortized cost; (2) debt and equity securities that are bought and held principally for the purpose of selling them in the near term are classified as "trading securities" and reported at fair value, with unrealized gains and losses included in net income; and (3) debt and equity securities not classified as either held-to-maturity securities or trading securities are classified as "available-for-sale securities" and reported at fair value, with unrealized gains and losses excluded from net income and reported in accumulated other comprehensive income, a separate component of stockholders' equity, net of deferred taxes. Fair value is determined from quoted prices obtained and reviewed by management. Held-to-maturity securities are stated at cost, adjusted for amortization of premiums and accretion of discounts on a basis, which approximates the level yield method. As of December 31, 2013 and 2012, the Company does not maintain trading securities. Gains or losses on disposition are based on the net proceeds and adjusted carrying values of the securities called or sold, using the specific identification method on a trade date basis.

Management evaluates securities for other-than-temporary ("OTTI") on a least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. The Company assesses OTTI or permanent impairment based upon whether it intends to sell a security or if it is likely that it would be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity. For debt securities, if the Company intends to sell the security or it is likely that the Company will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If the

Company does not intend to sell the security and it is not likely that the Company will be required to sell the security but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income ("OCI"). Impairment losses related to all other factors are presented as separate categories within OCI. For investment securities held to maturity, this amount is accreted over the remaining life of the debt security prospectively based on the amount and timing of future estimated cash flows. The accretion of the amount recorded in OCI increases the carrying value of the investment and does not affect earnings. If there is an indication of additional credit losses the security is re-evaluated according to the procedures described above.

(d) Restricted Equity Investments

As a member of the Federal Reserve Bank ("FRB") and the Federal Home Loan Bank ("FHLB") of Atlanta, the Company is required to maintain certain minimum investments in the common stock of the FRB and FHLB, which are carried at cost. Required levels of investment are based upon the Company's capital and a percentage of qualifying assets.

In addition, the Company is eligible to borrow from the FHLB with borrowings collateralized by qualifying assets, primarily residential mortgage loans, and the Company's capital stock investment in the FHLB.

Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB.

(e) Borrowings

At December 31, 2013, the Company's available borrowing limit with the FHLB was approximately $45,900. The Company had $0 in borrowings from the FHLB outstanding at December 31, 2013 and 2012. The Company also has a $3,000 line of credit commitment with no outstanding balance secured by the authorized capital stock of the Company with a correspondent bank. The Company has a term loan with the same correspondent bank with $1,630 outstanding as of December 31, 2013 and $1,900 outstanding as of December 31, 2012 with a 5.00% interest rate that matures on June 30, 2017.

(f) Loans and Allowance for Loan Losses

Loans are stated at the amount of unpaid principal, reduced by unearned income and fees on loans, and an allowance for loan losses. Income is recognized over the terms of the loans using methods that approximate the level yield method. The allowance for loan losses is a cumulative valuation allowance consisting of an annual provision for loan losses, plus any amounts recovered on loans previously charged off, minus loans charged off. The provision for loan losses charged to operations is the amount necessary in management's judgment to maintain the allowance for loan losses at a level it believes adequate to absorb probable losses inherent in the loan portfolio. Management determines the adequacy of the allowance based upon reviews of individual credits, recent loss experience, delinquencies, current economic conditions, the risk characteristics of the various categories of loans and other pertinent factors. Management uses historical loss data by loan type as well as current economic factors in its calculation of allowance for loan loss.

Management also uses qualitative factors such as changes in lending policies and procedures, changes in national and local economies, changes in the nature and volume of the loan portfolio, changes in experience of lenders and the loan department, changes in volume and severity of past due and classified loans, changes in quality of the Company's loan review system, the existence and effect of concentrations of credit and external factors such as competition and regulation in its allowance for loan loss calculation. Each qualitative factor is evaluated and applied to each type of loan in the Company's portfolio and a percentage of each loan is reserved as allowance. A percentage of each loan type is also reserved according to the loan type's historical loss data. Larger percentages of allowance are taken as the risk for a loan is determined to be greater. Loans are charged against the allowance for loan losses when management believes the collectability of the principal is uncollectible. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on changes in economic conditions or the Company's recent loss experience. It is reasonably possible that management's estimate of loan losses and the related allowance may change materially in the near term. However, the amount of change that is reasonably possible cannot be estimated. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examinations.

Loans are charged against the allowance when, in management's opinion, they are deemed doubtful, although the Company continues to aggressively pursue collection. The Company considers a number of factors to determine the need for and timing of charge-offs including the following: whenever any commercial loan becomes past due for 120 days for any scheduled principal or interest payment and collection is considered uncollectible; whenever foreclosure on real estate collateral or liquidation of other collateral does not result in full payment of the obligation and the deficiency or some portion thereof is deemed uncollectible, the uncollectible portion shall be charged-off; whenever any installment loan becomes past due for 120 days and collection is considered unlikely; whenever any repossessed vehicle remains unsold for 60 days after repossession; whenever a bankruptcy notice is received on any installment loan and review of the facts results in an assessment that all or most of the balance will not be collected, the loan will be placed in non-accrual status; whenever a bankruptcy notice is received on a small, unsecured, revolving installment account; and whenever any other small, unsecured, revolving installment account becomes past due for 180 days.

Loans are generally placed in non-accrual status when the collection of principal and interest is 90 days or more past due, unless the obligation relates to a consumer or residential real estate loan or is both well-secured and in the process of collection. All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Generally, loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured, which usually requires a minimum of six months of sustained repayment performance.

Impaired loans are required to be presented in the financial statements at net realizable value of the expected future cash flows or at the fair value of the loan's collateral. Homogeneous loans such as real estate mortgage loans, individual consumer loans and home equity loans are evaluated collectively for impairment. Management, considering current information and events regarding the borrower's ability to repay their obligations, considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impairment losses are included in the allowance for loan losses through a charge to the provision for loan losses. Cash receipts on impaired loans receivable are applied first to reduce interest on such loans to the extent of interest contractually due and any remaining amounts are applied to principal.

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported at the fair value of the collateral less cost to sell. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

(g) Loan Origination and Commitment Fees and Certain Related Direct Costs

Loan origination and commitment fees and certain direct loan origination costs charged by the Company are deferred and the net amount amortized as an adjustment of the related loan's yield. The Company amortizes these net amounts over the contractual life of the related loans or, in the case of demand loans, over the estimated life. Fees related to standby letters of credit are recognized over the commitment period.

(h) Bank Premises and Equipment

Bank premises and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed by the straight-line and declining-balance methods over the estimated useful lives of the assets. Depreciable lives include 15 years for land improvements, 40 years for buildings, and 3 to 7 years for equipment, furniture and fixtures. The cost of assets retired and sold and the related accumulated depreciation are eliminated from the accounts and the resulting gains or losses are included in determining net income. Expenditures for maintenance and repairs are charged to expense as incurred, and improvements and betterments are capitalized.

(i) Bank Owned Life Insurance

The Company has purchased life insurance policies on certain key members of management. Company 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.

(j) Goodwill

The Company performs a goodwill impairment analysis on an annual basis as of December 31st. Additionally, the Company performs a goodwill impairment evaluation on an interim basis when events or circumstances indicate impairment potentially exists. The Company performed goodwill impairment testing in the fourth quarter of 2013 because Bankshares' common stock had been trading below book value per share in 2013. Management determined that no goodwill impairment charge was required because the fair value of the Company was not less than the Company's carrying value. Management will continue to monitor the relationship of Bankshares' market capitalization to both its book value and tangible book value, which management attributes to both financial services industry-wide and Company-specific factors, and to evaluate the carrying value of goodwill.

While management has a plan to return the Company's business fundamentals to levels that support Bankshares' common stock trading at or above book value per common share, there is no assurance that the plan will be successful, or that the market price of the common stock will increase to such levels in the foreseeable future. If Bankshares' common stock price continues to trade below book value per common share, the Company may have to recognize an impairment of all, or some portion of, its goodwill.

(k) Foreclosed Assets

Foreclosed properties consist of properties acquired through foreclosure or deed in lieu of foreclosure. At time of foreclosure, the properties are recorded at the fair value less costs to sell. Subsequently, these properties are carried at the lower of cost or fair value less estimated costs to sell. Losses from the acquisition of property in full or partial satisfaction of loans are charged against the allowance for loan losses. Subsequent write-downs, if any, are charged to expense. Gains and losses on the sales of foreclosed properties are included in determining net income in the year of the sale.

(l) *Impairment or Disposal of Long-Lived Assets*

The Company's long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used, such as bank premises and equipment, is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of, such as foreclosed properties, are reported at the lower of the carrying amount or fair value less costs to sell.

(m) *Pension Plan*

The Company maintains a noncontributory defined benefit pension plan, which covers substantially all of its employees. The net periodic pension expense includes a service cost component, interest on the projected benefit obligation, a component reflecting the actual return on plan assets, the effect of deferring and amortizing certain actuarial gains and losses, and the amortization of any unrecognized net transition obligation on a straight-line basis over the average remaining service period of employees expected to receive benefits under the plan. The Company's funding policy is to make annual contributions in amounts necessary to satisfy the Internal Revenue Service's funding standards, to the extent that they are tax deductible.

ASC Topic 715, *Defined Benefit Pension Plans* requires a business entity to recognize the overfunded or underfunded status of a single-employer defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in comprehensive income in the year in which the changes occur. Defined Benefit Plans also requires a business entity to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions.

(n) *Advertising*

The Company recognizes advertising expenses as incurred.

(o) *Income Taxes*

Income taxes are accounted for under the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in net income in the period that includes the enactment date.

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

(p) Stock Options and Restricted Stock

The Company accounts for its stock based compensation plan by recognizing expense for options granted equal to the grant date fair value of the unvested amounts over their remaining vesting periods. There were 10,000 shares of restricted stock granted in 2013 compared to 11,000 shares of restricted stock granted in 2012. There were 37,000 stock options outstanding as of December 31, 2013compared to 37,250 stock options outstanding as of December 31, 2012. Future levels of compensation cost recognized related to share-based compensation awards may be impacted by new awards and/or modification, repurchases and cancellations of existing awards after the adoption of this standard.

(q) Net Income per Share

Basic net income per share excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock that are not anti-dilutive were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company.

The following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations for the periods indicated:

Year ended December 31, 2013	**Net income (numerator)**	**Shares (denominator)**	**Per share amount**
Basic net income per share	$ 3,017	1,512,545	$ 1.99
Effect of dilutive stock options	—	10,560	
Diluted net income per share	$ 3,017	1,523,105	$ 1.98

Year ended December 31, 2012	**Net income (numerator)**	**Shares (denominator)**	**Per share amount**
Basic net income per share	$ 1,338	1,503,952	$ 0.89
Effect of dilutive stock options	—	—	
Diluted net income per share	$ 1,338	1,503,952	$ 0.89

Year ended December 31, 2011	**Net income (numerator)**	**Shares (denominator)**	**Per share amount**
Basic net income per share	$ 1,063	1,496,260	$ 0.71
Effect of dilutive stock options	—	—	
Diluted net income per share	$ 1,063	1,496,260	$ 0.71

Options to purchase 37,000 shares which were outstanding as of December 31, 2013, and options to purchase 37,250 shares which were outstanding as of December 31, 2012, were not included in the computation of diluted EPS because the effect would have been anti-dilutive.

(r) Consolidated Statements of Cash Flows

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks (with original maturities of three months or less), and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

(s) Comprehensive Income

ASC Topic *Comprehensive Income,* requires the Company to classify items of "Other Comprehensive Income" (such as net unrealized gains (losses) on available-for-sale securities) by their nature in a financial statement and present the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position. The Company's other comprehensive income consists of net income, and net unrealized gains (losses) on securities available-for-sale, net of income taxes, and adjustments relating to its defined benefit plan, net of income taxes.

(t) *Fair Value Measurements*

ASC Topic, *Fair Value Measurements and Disclosures* establishes a framework for using fair value. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date.

In accordance with *Fair Value Measurements and Disclosures*, the Company groups its financial assets and financial liabilities in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The most significant instruments that the Company measures at fair value are available-for-sale securities. All available-for-sale securities fall into Level 2 fair value hierarchy. Valuation methodologies for the fair value hierarchy are as follows:

Level 1 – Valuations are based on quoted prices for identical assets and liabilities traded in active exchange markets, such as the New York Stock Exchange.

Level 2 – Valuations for assets and liabilities are obtained from readily available pricing sources via independent providers for market transactions involving similar assets or liabilities, model-based valuation techniques, or other observable inputs.

Level 3 – Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models and similar techniques, and are not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining fair value assigned to such assets and liabilities.

(u) *Current Accounting Developments*

In July 2012, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2012-02, *Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment*. The ASU simplifies the guidance for testing the decline in the realizable value (impairment) of indefinite-lived intangible assets other than goodwill. The amendments allow an organization the option to first assess qualitative factors to determine whether it is necessary to perform the quantitative impairment test. An organization electing to perform a qualitative assessment is no longer required to calculate the fair value of an indefinite-lived intangible asset unless the organization determines, based on a qualitative assessment, that it is "more likely than not" that the asset is impaired. Under former guidance, an organization was required to test an indefinite-lived intangible asset for impairment on at least an annual basis by comparing the fair value of the asset with its carrying amount. The amendments in this ASU are effective for annual and interim tests performed for fiscal years after September 15, 2012. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In January, 2013, the FASB issued ASU No. 2013-01, *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities.* ASU 2013-01 clarifies that ordinary trade receivables and receivables are not in the scope of ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities.* Specifically, ASU 2011-11 applies only to derivatives, repurchase agreements and reverse purchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with specific criteria contained in the *FASB Accounting Standards Codification*™ (Codification) or subject to a master netting arrangement or similar agreement. The FASB undertook this clarification project in response to concerns expressed by U.S. stakeholders about the standard's broad definition of financial instruments. After the standard was finalized, companies realized that many contracts have standard commercial provisions that would equate to a master netting arrangement, significantly increasing the cost of compliance at minimal value to financial statement users. An entity is required to apply the amendments in ASU 2013-01 for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the required disclosures retrospectively for all comparative periods presented. The effective date is the same as the effective date of ASU 2011-11. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In February 2013, the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income,* to improve the transparency of reporting these reclassifications. Other comprehensive income includes gains and losses that are initially excluded from net income for an accounting period. Those gains and losses are later reclassified out of accumulated other comprehensive income into net income. The amendments in this ASU do not change the current requirements for reporting net income or other comprehensive income in financial statements. All of the information that this ASU requires already is required to be disclosed elsewhere in the financial statements under U.S. GAAP. The new amendments will require an organization to present (either on the face of the statement where net income is presented or in the notes) the effects on the line items of net income of significant amounts reclassified out of accumulated other comprehensive income - but only if the item reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period and cross-reference to other disclosures currently required under U.S. GAAP for other reclassification items (that are not required under U.S. GAAP) to be reclassified directly to net income in their entirety in the same reporting period. This would be the case when a portion of the amount reclassified out of accumulated other comprehensive income is initially transferred to a balance sheet account (e.g., inventory for pension-related amounts) instead of directly to income or expense. The amendments apply to all companies that report items of other comprehensive income. Public companies are required to comply with these amendments for all reporting periods (interim and annual). A private company is required to meet the reporting requirements of the amended paragraphs about the roll forward of accumulated other comprehensive income for both interim and annual reporting periods. However, private companies are only required to provide the information about the effect of reclassifications on line items of net income for annual reporting periods, not for interim reporting periods. The amendments are effective for reporting periods beginning after December 15, 2012, for public companies. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In November 2013, the FASB has issued ASU No. 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force).* The amendments in this ASU state that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available as of the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. This ASU applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists as of the reporting date. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In January 2014, the FASB has issued Accounting Standards Update (ASU) No. 2014-04, *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.* The amendments are intended to clarify when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the real estate recognized. These amendments clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either: *(a)* the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure; or *(b)* the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additional disclosures are required. The amendments are effective for public business entities for annual periods and interim periods within those annual periods beginning after December 15, 2014. The adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.

(2) Restrictions on Cash

To comply with Federal Reserve regulations, the Company is required to maintain certain average reserve balances. The daily average reserve requirements were approximately \$3,098 and \$2,716 for the weeks including December 31, 2013 and 2012, respectively.

(3) Securities

The amortized costs, gross unrealized gains, gross unrealized losses and fair values for securities as of December 31, 2013 and 2012 are as follows:

	2013			
Available-for-Sale	**Amortized costs**	**Gross unrealized gains**	**Gross unrealized losses**	**Fair values**
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	$ 20,751	124	(278)	20,597
Obligations of states and political subdivisions	2,106	67	—	2,173
Mortgage-backed securities – government	489	37	—	526
Other securities	110	—	—	110
Total available-for-sale	$ 23,456	228	(278)	23,406

	2013			
Held-to-Maturity	**Amortized costs**	**Gross unrealized gains**	**Gross unrealized losses**	**Fair values**
Obligations of states and political subdivisions	$ 5,719	100	(20)	5,799

	2012			
Available-for-Sale	**Amortized costs**	**Gross unrealized gains**	**Gross unrealized losses**	**Fair values**
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	$ 11,150	261	—	11,411
Obligations of states and political subdivisions	2,816	183	—	2,999
Mortgage-backed securities – government	668	58	—	726
Other securities	110	—	—	110
Total available-for-sale	$ 14,744	502	—	15,246

	2012			
Held-to-Maturity	**Amortized costs**	**Gross unrealized gains**	**Gross unrealized losses**	**Fair values**
Obligations of states and political subdivisions	$ 6,960	227	(9)	7,178

The following table shows the gross unrealized losses and fair value of the Company's investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2013:

Description of Securities	Less than 12 months Fair value	Less than 12 months Gross unrealized losses	Total Fair value	Total Gross unrealized losses
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	$ 16,801	293	16,801	293
Total temporarily impaired securities	$ 16,801	293	16,801	293

Description of Securities	More than 12 months Fair value	More than 12 months Gross unrealized losses	Total Fair value	Total Gross unrealized losses
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	$ 272	5	272	5
Total temporarily impaired securities	$ 272	5	272	5

The following table shows the gross unrealized losses and fair value of the Company's investments, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of December 31, 2012:

Description of Securities	Less than 12 months Fair value	Less than 12 months Gross unrealized losses	Total Fair value	Total Gross Unrealized losses
Obligations of states and political subdivisions	$ 1,176	9	1,176	9
Total temporarily impaired securities	$ 1,176	9	1,176	9

The Company does not consider the unrealized losses other-than-temporary losses based on the volatility of the securities market price involved, the credit quality of the securities, and the Company's ability, if necessary, to hold the securities until maturity. The securities include 19 bonds that have continuous losses for less than 12 months and 2 bonds that have continuous losses for more than 12 months. There were no gross realized gains or losses on securities sold in 2013 and 2012.

The amortized costs and fair values of available-for-sale and held-to-maturity securities as of December 31, 2013, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	2013			
	Available-for-Sale		Held-to-Maturity	
	Amortized costs	Fair values	Amortized costs	Fair values
Due in one year or less	$ 110	110	-	-
Due after one year through five years	21,864	21,727	3,882	3,910
Due after five years through ten years	993	1,044	1,837	1,889
Due after ten years	102	109	—	—
	23,069	22,990	5,719	5,799
Mortgage-backed securities	387	416	—	—
Totals	$ 23,456	23,406	5,719	5,799

Securities with amortized costs of approximately $4,312 and $4,507 (fair values of $4,404 and $4,695, respectively) as of December 31, 2013 and 2012, respectively, were pledged as collateral for public deposits and to the Federal Reserve for overdraft protection.

(4) Loans, Allowance for Loan Losses and Credit Quality

A summary of loans as of December 31, 2013 and 2012 follows:

		2013	2012
Real estate loans:			
Residential-mortgage	$	104,046	105,246
Residential-construction		8,776	9,618
Commercial		89,670	86,283
Loans to individuals for household, family and other consumer expenditures		48,991	48,234
Commercial and industrial loans		26,373	28,054
Total loans, gross		277,856	277,435
Less unearned income and fees		(98)	(117)
Loans, net of unearned income and fees		277,758	277,318
Less allowance for loan losses		(3,409)	(3,646)
Loans, net	$	274,349	273,672

In the normal course of business, the Bank has made loans to executive officers and directors. As of December 31, 2013 and 2012, loans to executive officers and directors totaled $248 and $278 respectively. During 2013, new loans made to executive officers and directors totaled $149, advances totaled $40 and repayments amounted to approximately $41. Loans to companies in which executive officers and directors have an interest amounted to $0 and $698 as of December 31, 2013 and 2012, respectively. All such loans were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with unrelated persons, and, in the opinion of management, do not involve more than normal risk of collectability or present other unfavorable features.

The following table presents information on the Company's allowance for loan losses and recorded investment in loans:

Allowance for Loan Losses and Recorded Investment in Loans
For the Year Ended December 31, 2013

	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance for Loan Losses:					
Beginning balance	$324	$1,462	$445	$1,415	$3,646
Chargeoffs	(33)	(35)	(269)	(284)	(621)
Recoveries	23	6	223	52	304
Provision	(103)	264	35	(116)	80
Ending Balance	$211	$1,697	$434	$1,067	$3,409

	Commercial	Commercial Real Estate	Consumer	Residential	Total
Ending balance: individually evaluated for impairment	$-	-	-	-	-
Ending balance: collectively evaluated for impairment	$211	1,697	434	1,067	3,409
Loans:					
Total loans ending balance	$26,373	89,670	48,991	112,822	277,856
Ending balance: individually evaluated for impairment	$65	930	114	1,477	2,586
Ending balance: collectively evaluated for impairment	$26,308	88,740	48,877	111,345	275,270

For the Year Ended December 31, 2012

	Commercial	Commercial Real Estate	Consumer	Residential	Total
Allowance for Loan Losses:					
Beginning balance	$448	$1,489	$394	$1,684	$4,015
Chargeoffs	(84)	(345)	(404)	(1,218)	(2,051)
Recoveries	1	114	174	216	505
Provision	(41)	204	281	733	1,177
Ending Balance	$324	$1,462	$445	$1,415	$3,646
Ending balance individually evaluated for impairment	$-	-	-	-	-
Ending balance: collectively evaluated for impairment	$324	1,466	445	1,411	3,646
Loans:					
Total loans ending balance	$28,054	86,283	48,234	114,864	277,435
Ending balance: individually evaluated for impairment	$110	1,199	83	1,451	2,843
Ending balance: collectively evaluated for impairment	$27,944	85,084	48,151	113,413	274,592

The Company utilizes a risk rating matrix to assign a risk grade to each of its loans. A description of the general characteristics of the risk grades is as follows:

Pass – These loans have minimal and acceptable credit risk.

Special Mention – These loans have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at some future date.

Substandard – These loans are inadequately protected by the net worth or paying capacity of the obligor or collateral pledged, if any. Loans classified as substandard must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. A substandard loan is characterized by the distinct probability that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – These loans have all of the weakness inherent in one classified as substandard with the added characteristic that the weaknesses make collection liquidation in full, on the basis of the currently existing facts, conditions and values, highly questionable and improbable.

The following table illustrates the Company's credit quality indicators:

Credit Quality Indicators
As of December 31, 2013

Credit Exposure	Commercial	Commercial Real Estate	Consumer	Residential	Total
Pass	$25,852	85,290	48,765	111,120	271,027
Special Mention	450	721	-	15	1,186
Substandard	71	3,659	226	1,687	5,643
Doubtful	-	-	-	-	-
Total	$26,373	89,670	48,991	112,822	277,856

As of December 31, 2012

Credit Exposure	Commercial	Commercial Real Estate	Consumer	Residential	Total
Pass	$26,953	80,561	48,056	110,630	266,200
Special Mention	971	3,526	105	735	5,337
Substandard	130	2,196	73	3,499	5,898
Doubtful	-	-	-	-	-
Total	$28,054	86,283	48,234	114,864	277,435

The following table represents an age analysis of the Company's past due loans:

Age Analysis of Past Due Loans
As of December 31, 2013

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment 90 Days and Accruing
Commercial	$107	-	65	172	26,201	26,373	-
Commercial real estate	74	-	930	1,004	88,666	89,670	-
Consumer	334	9	114	457	48,534	48,991	-
Residential	265	134	1,477	1,876	110,946	112,822	-
Total	$780	143	2,586	3,509	274,347	277,856	-

As of December 31, 2012

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment 90 Days and Accruing
Commercial	$261	4	110	375	27,679	28,054	-
Commercial real estate	135	-	1,198	1,333	84,950	86,283	-
Consumer	427	58	83	568	47,666	48,234	-
Residential	1,495	87	1,623	3,205	111,659	114,864	171
Total	$2,318	149	3,014	5,481	271,954	277,435	171

As of December 31, 2013 and 2012, the recorded investment in loans for which impairment has been identified totaled approximately $2,586 and $2,843, respectively, with no corresponding valuation allowances for either year. The average recorded investment in impaired loans receivable during 2013 and 2012 was approximately $2,716 and $4,868, respectively. Interest income recognized on a cash basis on impaired loans during 2013 and 2012 was approximately $87 and $164, respectively.

The following table presents information on the Company's impaired loans and their related allowance for loan losses:

Impaired Loans

For the Year Ended December 31, 2013

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$65	65	-	88	7
Commercial real estate	930	930	-	1,064	27
Consumer	114	114	-	99	1
Residential	1,477	1,477	-	1,465	52
Total:					
Commercial	65	65	-	88	7
Commercial real estate	930	930	-	1,064	27
Consumer	114	114	-	99	1
Residential	$1,477	1,477	-	1,465	52

For the Year Ended December 31, 2012

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	$110	110	-	201	4
Commercial real estate	1,198	1,198	-	1,292	19
Consumer	83	83	-	114	1
Residential	1,452	1,452	-	3,167	140
With allowance recorded:					
Commercial real estate	-	-	-	6	-
Residential	-	-	-	88	-

Total:	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Commercial	110	110	-	201	4
Commercial real estate	1,198	1,198	-	1,298	19
Consumer	83	83	-	114	1
Residential	$1,452	1,452	-	3,255	140

The following presents information on the Company's nonaccrual loans:

Loans in Nonaccrual Status
As of December 31, 2013 and 2012

	2013	2012
Commercial	$65	$110
Commercial real estate	930	1,198
Consumer	114	83
Residential	1,477	1,452
Total	$2,586	$2,843

The Company had four restructured loans totaling $2,980 as of December 31, 2013 and had three restructured loans totaling $1,756 as of December 31, 2012.

The Company offers a variety of modifications to borrowers. The modification categories offered can generally be described in the following categories.

Rate Modification is a modification in which the interest rate is changed.

Term Modification is a modification in which the maturity date, timing of payments or frequency of payments is changed.

Interest Only Modification is a modification in which the loan is converted to interest only payments for a period of time.

Payment Modification is a modification in which the dollar amount of the payment is changed, other than an interest only modification described above.

Combination Modification is any other type of modification, including the use of multiple categories above.

There were no additional commitments to extend credit related to these troubled debt restructurings that were outstanding as of December 31, 2013 or December 31, 2012.

The following tables present troubled debt restructurings as of December 31, 2013 and 2012:

December 31, 2013

	Accrual Status	Non-Accrual Status	Total Modifications
Commercial	$ -	-	-
Commercial real estate	1,968	-	1,968
Consumer	-	-	-
Residential	555	457	1,012
Total	$2,523	457	2,980

December 31, 2012

	Accrual Status	Non-Accrual Status	Total Modifications
Commercial	$ -	-	-
Commercial real estate	666	-	666
Consumer	-	-	-
Residential	556	534	1,090
Total	$1,222	534	1,756

For 2013, there was one commercial real estate loan that was considered a combination modification that had a pre-modification balance of $1,327 and a post modification balance of $1,327 as of March 8, 2013. During 2012, there were no newly restructured loans.

(5) Bank Premises and Equipment

Bank premises and equipment, net were comprised of the following as of December 31, 2013 and 2012:

		2013	2012
Land improvements	$	571	536
Buildings		6,798	5,728
Equipment, furniture and fixtures		5,046	4,678
		12,415	10,942
Less accumulated depreciation		(6,797)	(6,309)
		5,618	4,633
Land		1,680	1,680
Bank premises and equipment, net	$	7,298	6,313

(6) Deposits

A summary of deposits as of December 31, 2013 and 2012 follows:

		2013	2012
Noninterest-bearing demand deposits	$	47,506	37,955
Interest-bearing:			
Savings and money market accounts		85,255	73,704
NOW accounts		68,911	67,463
Time deposits – under $100,000		82,318	90,341
Time deposits – $100,000 and over		38,140	45,694
Total interest-bearing deposits		274,624	277,202
Total deposits	$	322,130	315,157

At December 31, 2013, the scheduled maturity of time deposits is as follows: $52,306 in 2014; $29,908 in 2015; $7,480 in 2016; $4,558 in 2017 and $26,206 in 2018.

In the normal course of business, the Bank has received deposits from executive officers and directors. As of December 31, 2013 and 2012, deposits from executive officers and directors were approximately $2,223 and $3,225, respectively. All such deposits were received in the ordinary course of business on substantially the same terms and conditions, including interest rates, as those prevailing at the same time for comparable transactions with unrelated persons.

(7) Employee Benefit Plans

The Bank maintains a noncontributory defined benefit pension plan that covers substantially all of its employees. Benefits are computed based on employees' average final compensation and years of credited service. Pension expense amounted to approximately $620 and $456 in 2013 and 2012, respectively. The change in benefit obligation, change in plan assets and funded status of the pension plan as of December 31, 2013 and 2012 and pertinent assumptions are as follows:

		Pension Benefits	
Change in Benefit Obligation		2013	2012
Benefit obligation at beginning of year	$	8,259	6,892
Service cost		434	379
Interest cost		320	309
Actuarial loss		(1,227)	818
Benefits paid		(1,208)	(139)
Settlement Loss		(72)	—
Benefit obligation at end of year	$	6,506	8,259
Change in Plan Assets			
Fair value of plan assets at beginning of year		5,367	4,389
Actual return on plan assets		1,627	628
Employer contribution		3,000	489
Benefits paid		(1,208)	(139)
Projected fair value of plan assets at end of year	$	8,786	5,367
Funded Status at the End of the Year		2,280	(2,893)
Amounts Recognized in the Balance Sheet			
Other liabilities, accrued pension		2,280	(2,893)
Amounts Recognized in Accumulated Other Comprehensive Income Net of Tax Effect			
Unrecognized net actuarial loss		121	1,964
Benefit obligation included in accumulated other comprehensive income	$	121	1,964
Funded Status			
Benefit obligation		(6,506)	(8,259)
Fair value of assets		8,786	5,367
Unrecognized net actuarial loss		183	2,976
(Accrued)/prepaid benefit cost included in the balance sheet	$	2,463	84

	Pension Benefits	
Weighted Average Assumptions as of December 31, 2013 and 2012 :	2013	2012
Discount rate	5.00%	4.00%
Expected long-term return on plan assets	8.00%	8.00%
Rate of compensation increase	3.00%	3.00%

Pension Benefits

		2013	2012
Net (gain)/loss	$	(1,843)	280
Prior service cost		-	-
Amortization of prior service cost		-	-
Net obligation at transition		-	-
Amortization of net obligation at transition		-	-
Total recognized in other comprehensive income	$	(1,843)	280
Total Recognized in Net Periodic Benefit Cost and Other Comprehensive Income	$	(2,172)	879

The estimated portion of prior service cost and net transition obligation included in accumulated other comprehensive income that will be recognized as a component of net periodic pension cost over the next fiscal year are each $11.

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

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

The components of net pension benefit cost under the plan for the years ended December 31, 2013 and 2012 is summarized as follows:

		Pension Benefits	
		2013	2012
Service cost	$	434	379
Interest cost		320	310
Expected return on plan assets		(639)	(350)
Recognized net (gain)/loss due to settlement		368	—
Net amortization		—	—
Recognized net actuarial loss		137	117
Net pension benefit cost	$	620	456

Projected Benefit Payments

The projected benefit payments under the plan are summarized as follows for the years ending December 31:

2014	$ 466
2015	294
2016	299
2017	1,123
2018	294

Plan Asset Allocation

Plan assets are held in a pooled pension trust fund administered by the Virginia Bankers Association. The pooled pension trust fund is sufficiently diversified to maintain a reasonable level of risk without imprudently sacrificing return, with a targeted asset allocation of 20% fixed income and 80% equities. The Investment Manager selects investment fund managers with demonstrated experience and expertise, and funds with demonstrated historical performance, for the implementation of the pension plan's investment strategy. The Investment Manager will consider both actively and passively managed investment strategies and will allocate funds across the asset classes to develop an efficient investment structure.

It is the responsibility of the Virginia Bankers Association to administer the investments of the pooled pension trust fund within reasonable costs, being careful to avoid sacrificing quality. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs and other administrative costs.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs. Following is a description of the valuation methodologies used for assets measured at fair value.

Mutual funds-fixed income and equity funds: Valued at the net asset value of shares held at year-end.

Cash and equivalents: Valued at cost which approximates fair value.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine fair value of certain financial instruments could result in a different fair value measurement as of December 31, 2013.

The following table presents the fair value of the assets, by asset category, as of December 31, 2013 and 2012.

		2013	2012
Mutual funds-fixed income	$	2,109	1,333
Mutual funds-equity		6,677	4,034
Total assets at fair value	$	8,786	5,367

The following table sets forth by level, within the fair value hierarchy, the assets carried at fair value as of December 31, 2013 and 2012.

	Assets at Fair Value as of December 31, 2013			
	Level 1	Level 2	Level 3	Total
Mutual funds-fixed income	$ 2,109	-	-	2,109
Mutual funds-equity	6,677	-	-	6,677
Total assets at fair value	$ 8,786	-	-	8,786

	Assets at Fair Value as of December 31, 2012			
	Level 1	Level 2	Level 3	Total
Mutual funds-fixed income	$ 1,333	-	-	1,333
Mutual funds-equity	4,034	-	-	4,034
Total assets at fair value	$ 5,367	-	-	5,367

Contributions

The Company expects to contribute $0 to its pension plan in 2014 to fund our accrued pension liabilities resulting mainly from the market performance of underlying pension assets.

The Company also has a 401(k) plan under which the Company matches employee contributions to the plan. In 2013 and 2012, the Company matched 100% of the first 1% of salary deferral and 50% of the next 5% of salary deferral to the 401(k) savings provision. The amount expensed for the 401(k) plan was $118 during the year ended December 31, 2013 and $111 during the year ended December 31, 2012.

(8) Income Taxes

Income tax expense attributable to income before income tax expense for the years ended December 31, 2013 and 2012 is summarized as follows:

		2013	2012
Current	$	(41)	593
Deferred		916	26
Total income tax expense	$	875	619

Reported income tax expense for the years ended December 31, 2013 and 2012 differed from the amounts computed by applying the U.S. Federal income tax rate of 34% to income before income tax expense as a result of the following:

		2013	2012
Computed at statutory Federal tax rate	$	1,323	665
Increase (reduction) in income tax expense resulting from:			
Tax-exempt interest		(60)	(58)
Disallowance of interest expense		4	5
Involuntary conversion of insurance proceeds		(366)	
Other, net		(26)	7
Reported income tax expense	$	875	619

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31, 2013 and 2012 are as follows:

		2013	2012
Deferred tax assets:			
Loans, principally due to allowance for loan losses	$	696	753
Defined benefit plan valuation adjustments		61	1,012
Loans, due to unearned fees, net		12	16
Net unrelaized loss on available-for-sale securities		18	-
Other		175	297
Total gross deferred tax assets		962	2,078
Deferred tax liabilities:			
Bank premises and equipment, due to differences in depreciation		(142)	(196)
Accrued pension, due to actual pension contributions in excess of accrual for financial reporting purposes		(837)	(28)
Net unrealized gains on available-for-sale securities		-	(171)
Other		(162)	(184)
Total gross deferred tax liabilities		(1,141)	(579)
Net deferred tax asset, included in other assets	$	(179)	1,499

The Bank has determined that a valuation allowance for the gross deferred tax assets is not necessary as of December 31, 2013 and 2012, since realization of the entire gross deferred tax assets can be supported by the amounts of taxes paid during the carryback periods available under current tax laws.

The Company did not recognize any interest or penalties related to income tax during the years ended December 31, 2013 and 2012. The Company does not have an accrual for uncertain tax positions as deductions taken and benefits accrued are based on widely understood administrative practices and procedures and are based on clear and unambiguous tax law. Tax returns for all years 2009 and thereafter are subject to future examination by tax authorities.

(9) Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include mortgage sale lock commitments, commitments to extend credit and standby letters of credit. These instruments may involve, to varying degrees, credit risk in excess of the amount recognized in the balance sheets. The contract amounts of these instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

Credit risk is defined as the possibility of sustaining a loss because the other parties to a financial instrument fail to perform in accordance with the terms of the contract. The Company's maximum exposure to credit loss under commitments to extend credit and standby letters of credit is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The Company requires collateral to support financial instruments when it is deemed necessary. The Bank evaluates such customers' creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the counterparty. Collateral may include deposits held in financial institutions, U.S. Treasury securities, other marketable securities, real estate, accounts receivable, inventory, and property, plant and equipment.

Financial instruments whose contract amounts represent credit risk:

		December 31,	
		2013	**2012**
Mortgage rate lock commitments	$	-	3,002
Commitments to extend credit	$	59,322	60,168
Standby letters of credit	$	3,023	2,475

In the ordinary course of business, the Company may enter into mortgage rate lock commitments that are subsequently funded by the Company. The Company then sells the mortgage loan to a secondary market bank that had underwritten the mortgage loan before the Company funded the loan. The secondary market bank pays a fee that was agreed upon on the lock commitment date to the Company and buys the loan within five days of the initial funding by the Company.

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.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are primarily issued to support public and private borrowing arrangements, including bond financing and similar transactions. Unless renewed, substantially all of the Company's standby letters of credit commitments as of December 31, 2013 will expire within one year. Management does not anticipate any material losses as a result of these transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

(10) Leases

The Company leases premises and equipment under various operating lease agreements. Generally, operating leases provide for one or more renewal options on the same basis as current rental terms. Certain leases require increased rentals under cost-of-living escalation clauses. The following are future minimum lease payments as required under the agreements:

Year	Payments
2014	$141
2015	141
2016	149
2017	152
2018	152
After 2018	1,556
Total	$2,292

The Company entered into a lease of the Amherst branch facility, with an entity in which a director of the Company has a 50% ownership interest, in 2009. The original term of the lease is twenty years and may be renewed at the Company's option for two additional terms of five years each. The Company's current rental payment under the lease is $141 annually.

(11) Concentrations of Credit Risk and Contingencies

The Company grants commercial, residential and consumer loans to customers primarily in the central Virginia area. The Company has a diversified loan portfolio that is not dependent upon any particular economic sector. As a whole, the portfolio is affected by general economic conditions in the central Virginia region.

The Company's commercial and real estate loan portfolios are diversified, with no significant concentrations of credit other than the geographic focus on the central Virginia region. The installment loan portfolio consists of consumer loans primarily for automobiles and other personal property. Overall, the Company's loan portfolio is not concentrated within a single industry or group of industries, the loss of any one or more of which would generate a materially adverse impact on the business of the Company.

The Company has established operating policies relating to the credit process and collateral in loan originations. Loans to purchase real and personal property are generally collateralized by the related property. Credit approval is principally a function of collateral and the evaluation of the creditworthiness of the borrower based on available financial information.

At times, the Company may have cash and cash equivalents at a financial institution in excess of insured limits. The Company places its cash and cash equivalents with high credit quality financial institutions whose credit rating is monitored by management to minimize credit risk.

In the ordinary course of business, various claims and lawsuits are brought by and against the Company. In the opinion of management, there is no pending or threatened proceeding in which an adverse decision could result in a material adverse change in the Company's consolidated financial condition or results of operations.

(12) Dividend Restrictions and Capital Requirements

Bankshares' principal source of funds for dividend payments is dividends received from its subsidiary Bank. For the years ended December 31, 2013 and 2012, dividends from the subsidiary Bank totaled $546 and $385, respectively.

Substantially all of Bankshares' retained earnings consist of undistributed earnings of its subsidiary Bank, which are restricted by various regulations administered by federal banking regulatory agencies. Under applicable federal laws, the Comptroller of the Currency restricts, without prior approval, the total dividend payments of the Bank in any calendar year to the net profits of that year, as defined, combined with the retained net profits for the two preceding years. As of December 31, 2013, retained net profits of the Bank that were free of such restriction approximated $5,001.

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

Quantitative measures established by regulation to ensure capital adequacy require Bankshares and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2013, that Bankshares and the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2013, the most recent notification from Office of the Comptroller of the Currency categorized Bankshares and the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized," Bankshares and the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed Bankshares and the Bank's category.

Bankshares and the Bank's actual capital amounts and ratios are presented in the table below.

	Actual		For Capital Adequacy Purposes		To Be "Well Capitalized" Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2013:						
Total Capital						
(to Risk Weighted Assets):						
Bankshares consolidated	$ 35,394	12.10%	$ 23,383	8.0%	$ N/A	N/A
Bank	36,267	12.44%	23,321	8.0%	29,151	10.0%
Tier 1 Capital						
(to Risk Weighted Assets):						
Bankshares consolidated	31,923	10.92%	11,692	4.0%	N/A	N/A
Bank	32,796	11.25%	11,660	4.0%	17,491	6.0%
Tier 1 Capital (Leverage)						
(to Average Assets):						
Bankshares consolidated	31,923	8.98%	14,219	4.0%	N/A	N/A
Bank	32,796	9.25%	14,187	4.0%	17,284	5.0%

	Actual		For Capital Adequacy Purposes		To Be "Well Capitalized" Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2012:						
Total Capital						
(to Risk Weighted Assets):						
Bankshares consolidated	$ 32,771	11.39%	$ 23,011	8.0%	$ N/A	N/A
Bank	34,005	11.85%	22,957	8.0%	28,696	10.0%
Tier 1 Capital						
(to Risk Weighted Assets):						
Bankshares consolidated	29,183	10.15%	11,505	4.0%	N/A	N/A
Bank	30,417	10.60%	11,478	4.0%	17,217	6.0%
Tier 1 Capital (Leverage)						
(to Average Assets):						
Bankshares consolidated	29,183	8.49%	13,756	4.0%	N/A	N/A
Bank	30,417	8.86%	13,729	4.0%	17,161	5.0%

(13) Disclosures about Fair Value of Financial Instruments

Generally accepted accounting principles require the Company to disclose estimated fair values of its financial instruments.

The following methods and assumptions were used to estimate the approximate fair value of each class of financial instrument for which it is practicable to estimate that value.

(a) ***Securities***

The fair value of securities is estimated based on bid prices as quoted on national exchanges or bid quotations received from securities dealers. The fair value of certain state and municipal securities is not readily available through market sources other than dealer quotations; so fair value estimates are based on quoted market prices of similar instruments, adjusted for differences between the quoted instruments and the instruments being valued.

(b) ***Loans***

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, real estate - residential, real estate - other, loans to individuals and other loans. Each loan category is further segmented into fixed and adjustable rate interest terms.

The fair value of fixed rate loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan as well as estimates for prepayments. The estimate of maturity is based on the Company's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions.

(c) ***Deposits***

The fair value of demand deposits, NOW accounts, and savings deposits is the amount payable on demand. The fair value of fixed maturity time deposits, certificates of deposit is estimated by discounting scheduled cash flows through the estimated maturity using the rates currently offered for deposits or borrowings of similar remaining maturities.

(f) ***Commitments to Extend Credit and Standby Letters of Credit***

The only amounts recorded for commitments to extend credit and standby letters of credit are the deferred fees arising from these unrecognized financial instruments. These deferred fees are not deemed significant as of December 31, 2013 and 2012, and as such, the related fair values have not been estimated.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on and off-balance sheet financial instruments without attempting to estimate the value of anticipated funding needs and the value of assets and liabilities that are not considered financial instruments. Significant assets that are not considered financial assets include deferred tax assets and premises and equipment and other real estate owned. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

(g) ***Fair Value Methodologies***

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

Available-for-Sale Securities

Available-for-sale securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available, and would in such case be included as a Level 1 asset. The Company currently carries no Level 1 securities. If quoted prices are not available, valuations are obtained from readily available pricing sources from independent providers for market transactions involving similar assets or liabilities. The Company's principal market for these securities is the secondary institutional markets, and valuations are based on observable market data in those markets. These would be classified as Level 2 assets. The Company's entire available-for-sale securities portfolio is classified as Level 2 securities. The Company currently carries no Level 3 securities for which fair value would be determined using unobservable inputs.

<u>Loans</u>

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic, *Impairment of a Loan.* The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of a similar debt, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans at which fair value of the expected repayments or collateral exceed the recorded investments in such loans. As of December 31, 2013, substantially all of the impaired loans were evaluated based on the fair value of the collateral. In accordance with *Impairment of a Loan*, impaired loans where an allowance is established based on the fair value of the collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as a nonrecurring Level 2 asset. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as a nonrecurring Level 3 asset. For substantially all of the Company's impaired loans as of December 31, 2013 and December 31, 2012, the valuation methodology utilized by the Company was collateral based measurements such as a real estate appraisal and the primary unobservable input was adjustments for differences between the comparable real estate sales. The discount to reflect current market conditions and ultimately collectability ranged from 0% to 25% for each of the respective periods.

<u>Foreclosed Assets</u>

Foreclosed assets are adjusted to fair value less estimated selling costs upon transfer of the loans to foreclosed assets. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value less estimated selling costs. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on observable market price or a current appraised value, the Company records the foreclosed asset as a nonrecurring Level 2 asset. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as a nonrecurring Level 3 asset. For substantially all of the Company's foreclosed assets as of December 31, 2013 and December 31, 2012, the valuation methodology utilized by the Company was collateral based measurements such as a real estate appraisal and the primary unobservable input was adjustments for differences between the comparable real estate sales. The discount to reflect current market conditions ranged from 0% to 20% for each of the respective periods.

The following tables present information about certain assets and liabilities measured at fair value:

Fair Value Measurements on December 31, 2013

Description	Total Carrying Amount in The Consolidated Balance Sheet	Assets/Liabilities Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities	$23,406	$23,406	NA	$23,406	NA
Loans, net of unearned income and fees	$277,758	$281,842	NA	NA	$281,842
Impaired loans (nonrecurring)	$2,586	$2,586	NA	NA	$2,586
Foreclosed assets (nonrecurring)	$1,297	$1,297	NA	NA	$1,297
Deposits	$322,130	$323,856	NA	NA	$323,856

Fair Value Measurements on December 31, 2012

Description	Total Carrying Amount in The Consolidated Balance Sheet	Assets/Liabilities Measured at Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-sale securities	$15,246	$15,246	NA	$15,246	NA
Loans, net of unearned income and fees	$277,318	$282,724	NA	NA	$282,724
Impaired loans (nonrecurring)	$2,843	$2,843	NA	NA	$2,843
Foreclosed assets (nonrecurring)	$2,393	$2,393	NA	NA	$2,393
Deposits	$315,157	$317,922	NA	NA	$317,922

The following table sets forth a summary of changes in the fair value of the Company's nonrecurring Level 3 assets for the year ended December 31, 2013:

	Level 3 Assets Year Ended December 31, 2013		
		Impaired Loans	Foreclosed Assets
Balance, beginning of the year	$	2,843	2,393
Purchases, sales, issuances, and settlements (net)		(257)	(1,096)
Balance, end of year	$	2,586	1,297

There were no transfers between Level 1 and Level 2 investments during the year ended December 31, 2013.

The following table sets forth a summary of changes in the fair value of the Company's nonrecurring Level 3 assets for the year ended December 31, 2012:

	Level 3 Assets Year Ended December 31, 2012		
		Impaired Loans	Foreclosed Assets
Balance, beginning of the year	$	5,942	645
Purchases, sales, issuances, and settlements (net)		(3,099)	1,748
Balance, end of year	$	2,843	2,393

There were no significant transfers between Level 1 and Level 2 investments during the year ended December 31, 2012.

(14) Parent Company Financial Information

Condensed financial information of Bankshares ("Parent:) is presented below:

Condensed Balance Sheets

		December 31, 2013	2012
Assets			
Cash due from subsidiary	$	5	13
Investment in subsidiary, at equity		33,181	29,324
Other assets		776	680
Total assets	$	33,962	30,017
Liabilities and stockholders' equity			
Notes payable	$	1,630	1,900
Other liabilities		24	28
Total liabilities	$	1,654	1,928
Stockholders' equity			
Common stock of $3 par value, authorized 3,000,000 shares; issued and outstanding 1,515,007 shares in 2013 and 1,5087,589 in 2012	$	4,507	4,492
Capital surplus		1,035	987
Retained earnings		26,920	24,244
Accumulated other comprehensive income (loss), net		(154)	(1,634)
Total stockholders' equity	$	32,308	28,089
Commitments, contingencies and other matters		—	—
Total liabilities and stockholders' equity	$	33,962	30,017

Condensed Statements of Income

		Years ended December 31, 2013	2012
Income:			
Dividends from subsidiary	$	892	506
Equity in undistributed net income of subsidiary		2,315	1,052
Total Income		3,207	1,558
Expenses:			
Other expenses		288	333
Income before income tax benefit		2,919	1,225
Applicable income tax benefit		98	113
Net income	$	3,017	1,338

Condensed Statements of Cash Flows

		Years ended December 31, 2013	2012
Cash flows from operating activities:			
Net income	$	3,017	1,338
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net income of subsidiary		(2,315)	(1,052)
Increase in other assets		(97)	(113)
Net cash provided by operating activities		605	173
Cash flows from financing activities			
Cash dividends paid		(341)	(76)
Draw on line of credit		-	-
Repayment of line of credit		(272)	(102)
Increase (decrease) in other liabilities		(3)	2
Net cash provided by (used in) financing activities		(616)	(176)
Net increase (decrease) in cash due from subsidiary		(11)	(3)
Cash due from subsidiary, beginning of year		16	16
Cash due from subsidiary, end of year	$	5	13

(15) Stock-based Compensation

The Company currently has one incentive stock option plan. The 2004 Incentive Stock Plan (the 2004 Plan), pursuant to which the Company's Board of Directors may grant stock options and other equity-based awards to officers and key employees, was approved by shareholders on April 13, 2004 and became effective as of May 1, 2004. The 2004 Plan authorizes grants of up to 100,000 shares of the Company's authorized, but unissued common stock. Accordingly, 100,000 shares of authorized, but unissued common stock were reserved for use in the 2004 Plan. All stock options are granted with an exercise price equal to the stock's fair market value at the date of the grant. As of December 31, 2013, there were 30,250 shares available for grant under the 2004 Plan.

Stock options generally have 10-year terms, vest at the rate of 25% per year, and become fully exercisable four years from the date of grant.

During 2013 and 2012, no stock options were granted or exercised. On May 1, 2013 and 2012, 10,000 and 11,000 shares, respectively, of restricted stock were granted to employees. The 2013 and 2012 grants will vest on the third anniversary of the grant date. On May 1, 2010, 48,000 shares in incentive stock awards were granted to employees. These equity awards included 37,500 shares in the form of incentive stock options with tandem stock appreciation rights with a four year vesting period, and 10,500 shares of restricted stock that vest on the third anniversary of the grant date were granted to employees.

At December 31, 2013, options for 27,750 shares were exercisable at an exercise price of $9.00 per share.

The Company expensed $9 in 2013 in compensation expense as a direct result of the issuance of the 45,000 incentive stock options with tandem stock appreciation rights in previous years and will recognize $3 in 2014 in compensation expense related to unvested stock options. The fair value $3.96 per share of each option grant is estimated on the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions used: dividend yield of 2.065%, expected volatility of 45.61%, a risk-free interest rate of 4.63%, and expected lives of 9 years.

The Company also expensed $54 in 2013 in compensation expense as a direct result of the granting of 10,500 shares of restricted stock in 2010, 1,000 shares of restricted stock in 2011 and 11,000 shares of restricted stock in 2012 and will recognize $77 in 2014, $53 in 2015 and $14 in 2016.

Stock option activity during the years ended December 31, 2013 and 2012 is as follows:

	Number of Shares	Weighted Average Exercise Price
Balance as of December 31, 2011	45,000	$10.66
Forfeited	7,750	14.56
Exercised	-	
Granted	-	
Balance as of December 31, 2012	37,250	$9.00
Forfeited	250	$9.00
Exercised	-	
Granted	-	
Balance as of December 31, 2013	37,000	$9.00

The following table summarizes information about stock options outstanding as of December 31, 2013:

Exercise Price	Number Outstanding at 12/31/13	Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price	Number Exercisable at 12/31/2013	Weighted-Average Exercise Price
$ 9.00	37,000	6.4	$ 9.00	27,750	$ 9.00

The aggregate intrinsic value of options outstanding was $226, of options exercisable was $169, and of options unvested and expected to vest was $57 as of December 31, 2013. The aggregate intrinsic value of restricted stock granted during 2013 was $491. The total intrinsic value (market value on date of exercise less exercise price) of options exercised during each of the years ended December 31, 2013 and 2012 was $0.

The following table summarizes information about stock options outstanding at December 31, 2012:

Exercise Price	Number Outstanding at 12/31/12	Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price	Number Exercisable at 12/31/2012	Weighted-Average Exercise Price
$ 9.00	37,250	7.4	$ 9.00	18,125	$ 9.00

(16) Share Repurchase Program

On November 12, 2013, the Board of Directors adopted a resolution authorizing the repurchase of up to $500 of shares of the Company's common stock. Purchases will be made, as conditions warrant, from time to time in the open market. The duration of the program is for six months and the timing of purchases will depend on market conditions. As of December 31, 2013, the Company had not yet repurchased shares of its common stock under the 2013 stock repurchase program. The timing and amount of future repurchases will depend upon the market price for our common stock, securities laws restricting repurchases, asset growth, earnings, and our capital plan.

(17) Subsequent Events

The Company has evaluated subsequent events for potential recognition and/or disclosure in the December 31, 2013 consolidated financial statements through March 3, 2014, the date the consolidated financial statements were available to be issued.

Management's Report on Internal Control over Financial Reporting.

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2013. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control – Integrated Framework*. Based on this assessment, our management concluded that, as of December 31, 2013, the Company's internal control over financial reporting was effective based on those criteria.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting.

Changes in Internal Controls.

No changes in our internal control over financial reporting occurred during the quarter ended December 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Cherry Bekaert LLP
CPAs & Advisors

Report of Independent Auditor

To the Board of Directors and Stockholders
of Pinnacle Bankshares Corporation
AltaVista, Virginia

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Pinnacle Bankshares Corporation and Subsidiary (The "Company"), which comprise the consolidated balance sheet as of December 31, 2013, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the 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; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pinnacle Bankshares Corporation and Subsidiary as of December 31, 2013, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Cherry Bekaert LLP

Raleigh, North Carolina
March 3, 2014

Cherry Bekaert LLP
CPAs & Advisors

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Pinnacle Bankshares Corporation
Altavista, Virginia

We have audited the accompanying consolidated balance sheet of Pinnacle Bankshares Corporation and Subsidiary (the "Company") as of December 31, 2012, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the ended December 31, 2012. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pinnacle Bankshares Corporation and Subsidiary as of December 31, 2012, and the results of operations and cash flows for the year ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

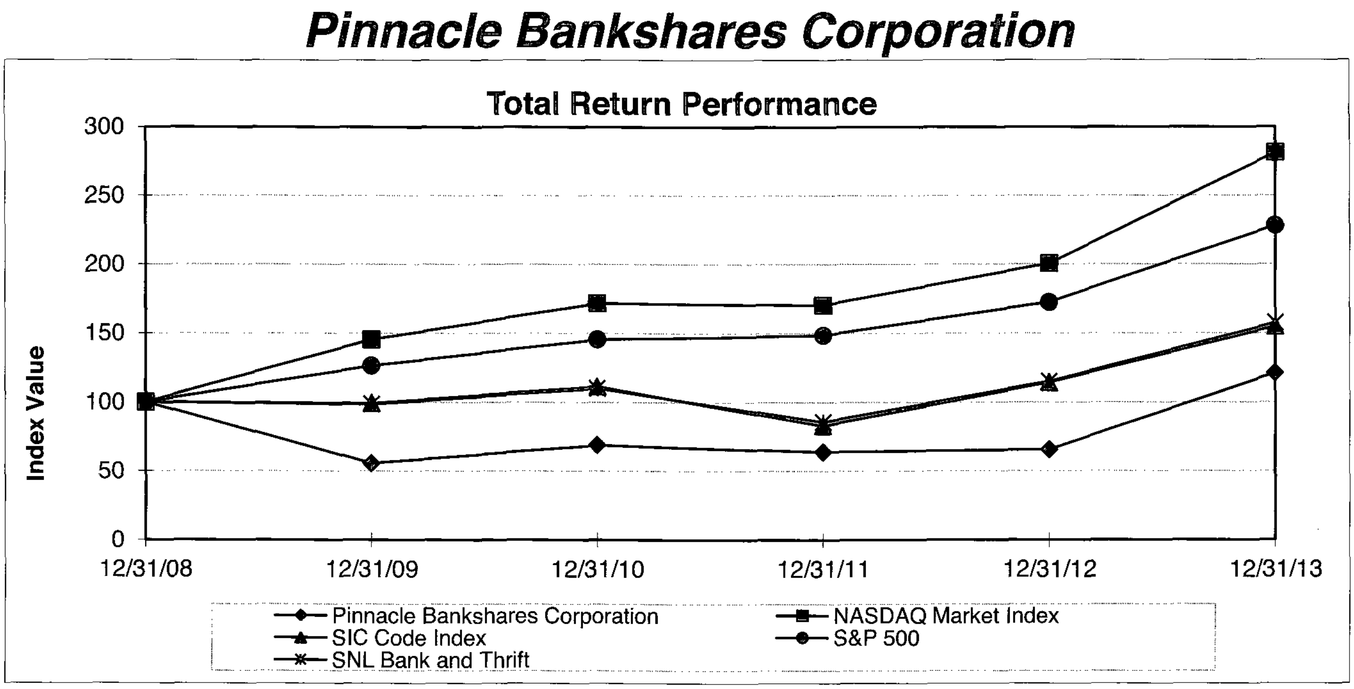
Cherry Bekaert LLP

Raleigh, North Carolina
March 27, 2013

Shareholder Information

PERFORMANCE GRAPH

The graph below compares total returns assuming reinvestment of dividends of Pinnacle Bankshares Common Stock, the NASDAQ Market Index, and an Industry Peer Group Index. In addition, we have included the S&P 500 and the SNL Bank and Thrift Index and will use these as our peer groups going forward as we have determined that the companies included in these indices more closely match our Company characteristics than the companies included in the SIC Code Index. The graph assumes $100 invested on January 1, 2008 in Pinnacle Bankshares Corporation Common Stock and in each of the indices. In 2013, the financial holding companies in the SIC Code Index consisted of 218 banks with the same standard industry code of 6021 as Pinnacle Bankshares Corporation.



Index	12/31/08	*Period Ending* 12/31/09	12/31/10	12/31/11	12/31/12	12/31/13
Pinnacle Bankshares Corporation	100.00	55.59	68.86	63.85	65.41	121.01
NASDAQ Market Index	100.00	145.36	171.74	170.38	200.63	281.22
SIC Code Index	100.00	99.38	111.37	82.95	114.22	154.77
S&P 500	100.00	126.46	145.51	148.59	172.37	228.19
SNL Bank and Thrift	100.00	98.66	110.14	85.64	115.00	157.46

Shareholder Information

Annual Meeting

The 2014 Annual Meeting of Shareholders will be held on April 8, 2014, at 11:00 a.m. at the Fellowship Hall of Altavista Presbyterian Church, located at 707 Broad Street, Altavista, Virginia.

Market for Common Equity and Related Stockholder Matters

The Company's Common Stock is quoted on the OTC Bulletin Board. The following table presents the high and low bid prices per share of the Common Stock, as reported on the OTCQB marketplace, and dividend information of the Company for the quarters presented. The high and low bid prices of the Common Stock presented below reflect inter-dealer prices and do not include retail markups, markdowns or commissions, and may not represent actual transactions.

	2013			2012		
	High	Low	Dividends	High	Low	Dividends
First Quarter	$13.45	$8.31	$0.05	$9.50	$8.16	$0.00
Second Quarter	$13.20	$11.75	$0.05	$10.50	$9.10	$0.00
Third Quarter	$13.10	$11.90	$0.05	$9.23	$7.71	$0.00
Fourth Quarter	$16.00	$13.10	$0.075	$9.10	$8.02	$0.05

Each share of Common Stock is entitled to participate equally in dividends, which are payable as and when determined by the Board of Directors after consideration of the earnings, general economic conditions, the financial condition of the business and other factors as might be appropriate. The Company's ability to pay dividends is dependent upon its receipt of dividends from its subsidiary. Prior approval from the Comptroller of the Currency is required if the total of all dividends declared by a national bank, including the proposed dividend, in any calendar year will exceed the sum of the Bank's net profits for that year and its retained net profits for the preceding two calendar years, less any required transfers to surplus. This limitation has not had a material impact on the Bank's ability to declare dividends during 2013 and 2012 and is not expected to have a material impact during 2014.

As of March 1, 2014, there were approximately 335 shareholders of record of Bankshares' Common Stock.

Requests for Information

Requests for information about the Company should be directed to Bryan M. Lemley, Secretary, Treasurer and Chief Financial Officer, P.O. Box 29, Altavista, Virginia 24517, telephone (434) 369-3000.

Shareholders seeking information regarding lost certificates and dividends should contact Registrar and Transfer Company in Cranford, New Jersey, telephone (800) 368-5948. Please submit address changes in writing to:

Registrar and Transfer Company
Investor Relations Department
10 Commerce Drive
Cranford, New Jersey 07016-9982

OUR NEW VISTA BRANCH

The bricks framing this plaque were retrieved from the original Vista Branch destroyed in the fire that occurred on April 10, 2012. They are a reminder of our company's resilience and ability to overcome adversity.

In honor of the extraordinary efforts of our employees, whose fast actions prevented injury and loss of customer assets, and in honor of First National Bank's commitment to the Altavista Community, we proudly dedicate this facility.

MAY 2013

PINNACLE BANKSHARES CORPORATION

622 Broad Street
Post Office Box 29
Altavista, Virginia 24517
(434) 369-3000