OLD POINT FINANCIAL CORP
Form 10-Q
November 14, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______ to _______
Commission File Number: 000-12896

OLD POINT FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

VIRGINIA	54-1265373
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1 West Mellen Street, Hampton, Virginia 23663
(Address of principal executive offices) (Zip Code)

(757) 728-1200
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
x Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
o Yes x No

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

4,959,009 shares of common stock ($5.00 par value) outstanding as of October 31, 2011

OLD POINT FINANCIAL CORPORATION

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

Old Point Financial Corporation and Subsidiaries
Consolidated Balance Sheets

	September 30, 2011 (unaudited)	December 31, 2010
Assets		
Cash and due from banks	$ 13,120,681	$ 14,206,869
Interest-bearing due from banks	30,801,094	1,396,462
Federal funds sold	2,598,375	12,827,818
Cash and cash equivalents	46,520,150	28,431,149
Securities available-for-sale, at fair value	209,348,054	206,091,712
Securities held-to-maturity		
(fair value approximates $2,272,477 and $1,956,720)	2,252,000	1,952,000
Restricted securities	3,679,300	4,319,600
Loans, net of allowance for loan losses of $9,752,238 and $13,227,791	517,281,949	573,390,522
Premises and equipment, net	30,074,896	29,615,688
Bank-owned life insurance	21,383,235	18,019,727
Foreclosed assets, net of valuation allowance of $2,318,094 and $2,123,930	11,037,696	11,447,794
Other assets	10,991,456	13,573,303
	$ 852,568,736	$ 886,841,495
Liabilities & Stockholders' Equity		
Deposits:		
Noninterest-bearing deposits	$ 159,162,963	$ 129,207,887
Savings deposits	232,083,576	225,209,590
Time deposits	299,155,153	324,796,068
Total deposits	690,401,692	679,213,545
Federal funds purchased and other borrowings	619,210	731,332
Overnight repurchase agreements	37,877,091	50,757,247
Term repurchase agreements	1,915,537	38,959,359
Federal Home Loan Bank advances	35,000,000	35,000,000
Accrued expenses and other liabilities	1,412,784	1,228,363
Total liabilities	767,226,314	805,889,846
Commitments and contingencies		
Stockholders' equity:		
Common stock, $5 par value, 10,000,000 shares authorized; 4,959,009 and 4,936,989 shares issued and outstanding	24,795,045	24,684,945
Additional paid-in capital	16,282,633	16,026,062
Retained earnings	44,490,439	42,809,769
Accumulated other comprehensive loss, net	(225,695)	(2,569,127)

Total stockholders' equity	85,342,422	80,951,649
Total liabilities and stockholders' equity	$ 852,568,736	$ 886,841,495

See Notes to Consolidated Financial Statements.

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Old Point Financial Corporation and Subsidiaries

Consolidated Statements of Income

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(unaudited)		(unaudited)	
Interest and Dividend Income:				
Interest and fees on loans	$7,923,224	$9,237,260	$24,516,542	$27,982,311
Interest on due from banks	2,772	615	4,070	1,817
Interest on federal funds sold	6,855	15,471	21,011	63,954
Interest on securities:				
Taxable	1,010,473	854,323	2,809,242	2,507,614
Tax-exempt	31,843	53,104	109,250	220,630
Dividends and interest on all other securities	16,756	11,650	48,852	32,815
Total interest and dividend income	8,991,923	10,172,423	27,508,967	30,809,141
Interest Expense:				
Interest on savings deposits	101,393	108,701	309,742	302,159
Interest on time deposits	1,070,753	1,604,779	3,480,563	5,168,834
Interest on federal funds purchased, securities sold under agreements to repurchase and other borrowings	17,170	109,603	87,859	470,751
Interest on Federal Home Loan Bank advances	429,717	429,717	1,275,138	1,969,974
Total interest expense	1,619,033	2,252,800	5,153,302	7,911,718
Net interest income	7,372,890	7,919,623	22,355,665	22,897,423
Provision for loan losses	600,000	1,500,000	2,900,000	7,500,000
Net interest income, after provision for loan losses	6,772,890	6,419,623	19,455,665	15,397,423
Noninterest Income:				
Income from fiduciary activities	713,946	718,008	2,244,842	2,319,856
Service charges on deposit accounts	1,090,057	1,068,455	3,156,810	3,663,196
Other service charges, commissions and fees	726,866	719,193	2,285,238	2,163,999
Income from bank-owned life insurance	207,984	216,218	612,900	815,541
Gain on sale of available-for-sale securities, net	386,091	541,241	437,046	541,317
Other operating income	75,802	130,072	218,874	311,119
Total noninterest income	3,200,746	3,393,187	8,955,710	9,815,028
Noninterest Expense:				
Salaries and employee benefits	4,834,750	4,539,062	14,360,119	13,691,812
Occupancy and equipment	1,090,300	1,084,972	3,226,185	3,235,289
FDIC insurance	271,462	404,093	942,941	1,050,274
Data processing	358,774	316,123	1,025,173	917,931
Customer development	223,733	215,414	663,203	655,644
Advertising	131,340	177,369	417,874	527,650
Loan expenses	210,285	117,658	627,829	481,531
Other outside service fees	163,336	157,932	464,174	357,518
Employee professional development	136,185	119,047	448,392	379,086
Postage and courier expense	123,365	123,287	366,649	393,689
Legal and audit expenses	176,161	244,760	539,188	564,498
Loss on write-down/sale of foreclosed assets	368,213	480,801	825,763	429,754

Other operating expenses	450,606	421,730	1,296,811	1,423,877
Total noninterest expense	8,538,510	8,402,248	25,204,301	24,108,553
Income before income taxes	1,435,126	1,410,562	3,207,074	1,103,898
Income tax expense	391,847	376,052	783,841	6,919
Net income	$1,043,279	$1,034,510	$2,423,233	$1,096,979
Basic Earnings per Share:				
Average shares outstanding	4,957,623	4,930,578	4,950,056	4,925,571
Net income per share of common stock	$0.21	$0.21	$0.49	$0.22
Diluted Earnings per Share:				
Average shares outstanding	4,957,623	4,932,731	4,950,056	4,931,977
Net income per share of common stock	$0.21	$0.21	$0.49	$0.22

See Notes to Consolidated Financial Statements.

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Old Point Financial Corporation and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity

(unaudited)	Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011						
Balance at beginning of period	4,936,989	$ 24,684,945	$16,026,062	$42,809,769	$ (2,569,127)	$80,951,649
Comprehensive income:						
Net income	0	0	0	2,423,233	0	2,423,233
Unrealized holding gains arising during the period						
(net of tax, $1,207,223, and reclassification adjustment)	0	0	0	0	2,343,432	2,343,432
Total comprehensive income	0	0	0	2,423,233	2,343,432	4,766,665
Exercise of stock options	22,020	110,100	174,105	0	0	284,205
Stock compensation expense	0	0	82,466	0	0	82,466
Cash dividends ($0.15 per share)	0	0	0	(742,563)	0	(742,563)
Balance at end of period	4,959,009	$ 24,795,045	$16,282,633	$44,490,439	$ (225,695)	$85,342,422
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010						
Balance at beginning of period	4,916,535	$ 24,582,675	$15,768,840	$42,518,889	$ (1,261,951)	$81,608,453
Comprehensive income:						
Net income	0	0	0	1,096,979	0	1,096,979
Unrealized holding gains arising during the period						
(net of tax, $567,493, and reclassification adjustment)	0	0	0	0	1,101,602	1,101,602
	0	0	0	1,096,979	1,101,602	2,198,581

Total comprehensive income						
Exercise of stock options	23,874	119,370	126,514	0	0	245,884
Tax benefit from disqualification of stock options	0	0	16,324	0	0	16,324
Repurchase and retirement of common stock	(3,420)	(17,100)	0	(23,974)	0	(41,074)
Stock compensation expense	0	0	85,398	0	0	85,398
Cash dividends ($0.20 per share)	0	0	0	(985,124)	0	(985,124)
Balance at end of period	4,936,989	$ 24,684,945	$ 15,997,076	$ 42,606,770	$ (160,349)	$ 83,128,442

See Notes to Consolidated Financial Statements.

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Old Point Financial Corporation and Subsidiaries

Consolidated Statements of Cash Flows

	Nine Months Ended September 30, 2011	2010
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$2,423,233	$1,096,979
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,364,475	1,476,008
Provision for loan losses	2,900,000	7,500,000
Net gain on sale of available-for-sale securities	(437,046)	(541,317)
Net amortization of securities	152,189	25,772
Net (gain) loss on disposal of premises and equipment	(1,294)	3,373
Net loss on write-down/sale of foreclosed assets	825,763	429,754
Income from bank owned life insurance	(612,900)	(815,541)
Stock compensation expense	82,466	85,398
Deferred tax (benefit) expense	860,930	(2,038,791)
Increase in other assets	(675,180)	(3,268,956)
Increase (decrease) in other liabilities	184,421	(376,564)
Net cash provided by operating activities	7,067,057	3,576,115
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of available-for-sale securities	(146,849,456)	(195,846,321)
Purchases of held-to-maturity securities	(2,000,000)	(1,370,000)
Proceeds from sales of restricted securities	640,300	332,900
Proceeds from maturities and calls of securities	97,722,651	88,012,522
Proceeds from sales of available-for-sale securities	51,405,975	90,683,319
Decrease in loans made to customers	53,208,573	15,246,981
Proceeds from sales of foreclosed assets	772,601	1,322,176
Purchases of bank owned life insurance	(2,750,000)	(940,000)
Purchases of premises and equipment	(1,822,389)	(806,309)
Net cash provided by (used in) investing activities	50,328,255	(3,364,732)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in noninterest-bearing deposits	29,955,076	17,565,383
Increase in savings deposits	6,873,986	18,419,190
Decrease in time deposits	(25,640,915)	(1,823,225)
Decrease in federal funds purchased, repurchase agreements and other borrowings	(50,036,100)	(8,010,400)
Decrease in Federal Home Loan Bank advances	0	(30,000,000)
Proceeds from exercise of stock options	284,205	245,884
Repurchase and retirement of common stock	0	(41,074)
Tax benefit from disqualification of stock options	0	16,324
Cash dividends paid on common stock	(742,563)	(985,124)
Net cash used in financing activities	(39,306,311)	(4,613,042)
Net increase (decrease) in cash and cash equivalents	18,089,001	(4,401,659)
Cash and cash equivalents at beginning of period	28,431,149	47,635,998
Cash and cash equivalents at end of period	$46,520,150	$43,234,339

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash payments for:		
Interest	$5,374,688	$8,435,557
Income tax	$0	$2,100,000
SUPPLEMENTAL SCHEDULE OF NONCASH TRANSACTIONS		
Unrealized gain on investment securities	$3,550,655	$1,669,095
Loans transferred to foreclosed assets	$2,197,810	$4,277,600

See Notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1. General

The accompanying unaudited consolidated financial statements of Old Point Financial Corporation (the Company) and its subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. All significant intercompany balances and transactions have been eliminated. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments and reclassifications of a normal and recurring nature considered necessary to present fairly the financial positions at September 30, 2011 and December 31, 2010, the results of operations for the three and nine months ended September 30, 2011 and 2010 and statement of cash flows and changes in stockholders' equity for the nine months ended September 30, 2011 and 2010. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year.

These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2010 annual report on Form 10-K. Certain previously reported amounts have been reclassified to conform to current period presentation.

AVAILABLE INFORMATION

The Company maintains a website on the Internet at www.oldpoint.com. The Company makes available free of charge, on or through its website, its proxy statements, annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission (SEC). The information available on the Company's Internet website is not part of this Form 10-Q or any other report filed by the Company with the SEC. The public may read and copy any documents the Company files at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The Company's SEC filings can also be obtained on the SEC's website on the Internet at www.sec.gov.

Note 2. Securities

Amortized costs and fair values of securities held-to-maturity are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
September 30, 2011				
Obligations of U.S. Government agencies	$ 1,970	$ 13	$ 0	$ 1,983
Obligations of state and political subdivisions	282	7	0	289
Total	$ 2,252	$ 20	$ 0	$ 2,272
December 31, 2010				
Obligations of U.S. Government agencies	$ 1,670	$ 4	$ (7)	$ 1,667
Obligations of state and political subdivisions	282	8	0	290
Total	$ 1,952	$ 12	$ (7)	$ 1,957

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Amortized costs and fair values of securities available-for-sale are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(in thousands)		
September 30, 2011				
U.S. Treasury securities	$ 600	$ 0	$ 0	$ 600
Obligations of U.S. Government agencies	157,203	1,907	0	159,110
Obligations of state and political subdivisions	2,279	79	0	2,358
Mortgage-backed securities	46,180	164	(2)	46,342
Money market investments	938	0	0	938
Total	$ 207,200	$ 2,150	$ (2)	$ 209,348
December 31, 2010				
U.S. Treasury securities	$ 600	$ 0	$ 0	$ 600
Obligations of U.S. Government agencies	201,601	513	(1,993)	200,121
Obligations of state and political subdivisions	3,103	69	0	3,172
Mortgage-backed securities	374	8	0	382
Money market investments	1,817	0	0	1,817
Total	$ 207,495	$ 590	$ (1,993)	$ 206,092

TEMPORARILY IMPAIRED SECURITIES

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position. The Company had no held-to-maturity securities with unrealized losses at September 30, 2011.

	September 30, 2011					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
	(in thousands)					
Securities Available-for-Sale						
Debt securities:						
Mortgage-backed securities	$ 2	$ 10,276	0	0	2	10,276

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	December 31, 2010					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
	(in thousands)					
Securities Available-for-Sale						
Obligations of U. S. Government agencies	$ 1,993	$ 128,362	$ 0	$ 0	$ 1,993	$ 128,362
Securities Held-to-Maturity						
Obligations of U. S. Government agencies	$ 7	$ 762	$ 0	$ 0	$ 7	$ 762
Total	$ 2,000	$ 129,124	$ 0	$ 0	$ 2,000	$ 129,124

Obligations of U.S. Government agencies
The U.S. Government agencies portfolio had fifteen investments with unrealized losses at December 31, 2010. This portfolio had no investments with unrealized losses as of September 30, 2011. The unrealized losses were caused by increases in market interest rates. The contractual terms of those investments do not permit the issuer to sell the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments, and management believes it is unlikely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2010.

Mortgage-backed securities
The Company's portfolio of mortgage-backed securities had one investment with unrealized losses at September 30, 2011. This portfolio had no investments with unrealized losses as of December 31, 2010. The unrealized losses were caused by increases in market interest rates. Because the Company does not intend to sell the investments, and management believes it is unlikely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity, the Company does not consider those investments to be other-than-temporarily impaired at September 30, 2011.

OTHER-THAN-TEMPORARILY IMPAIRED SECURITIES
Management assesses whether the Company intends to sell or it is more-likely-than-not that the Company will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired and that the Company does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the Company separates the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and is recognized in other comprehensive income.

The present value of expected future cash flows is determined using the best-estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best-estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds, and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances including timing, security interests, and loss severity.

The Company has a process in place to identify debt securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts, and cash flow projections as indicators of credit issues. On a quarterly basis, management reviews all securities to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. Management considers relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other-than-temporary. Relevant facts and circumstances considered include: (a) the extent and length of time the fair value has been below cost; (b) the reasons for the decline in value; (c) the financial position and access to capital of the issuer, including the current and future impact of any specific events and (d) for fixed maturity securities, the Company’s intent to sell a security or whether it is more-likely-than-not the Company will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and for equity securities, the Company’s ability and intent to hold the security for a period of time that allows for the recovery in value.

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The Company has not recorded impairment charges on securities for the nine months ended September 30, 2011 or the year ended December 31, 2010.

The unrealized losses in the securities portfolio as of September 30, 2011 relate to mortgage-backed securities, and the unrealized losses in the securities portfolio as of December 31, 2010 relate to obligations of U.S. Government agencies. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. The unrealized losses are a result of changes in market interest rates and not credit issues. Since the Company has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other than temporary.

The restricted securities category on the balance sheets is comprised of Federal Home Loan Bank of Atlanta (FHLB) and Federal Reserve Bank (FRB) stock. These stocks are classified as restricted securities because their ownership is restricted to certain types of entities and the securities lack a market. Therefore, FHLB and FRB stock is carried at cost and evaluated for impairment. When evaluating these stocks for impairment, their value is determined based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. Restricted stock is viewed as a long-term investment and management believes that the Company has the ability and the intent to hold this stock until its value is recovered.

The Company evaluated the positive and negative factors of FHLB stock for impairment and determined the stock not to be impaired at September 30, 2011 or December 31, 2010. This analysis is based on the following information. The FHLB reported net income of approximately $278 million for 2010, and paid a quarterly dividend for all four quarters of 2010. In 2011, the FHLB reported net income of approximately $51 million for the first quarter and $38 million for the second quarter, and declared a first quarter dividend in May 2011 and a second quarter dividend in August. On October 27, 2011, the FHLB declared a third quarter dividend and announced it would continue repurchasing excess stock from shareholders.

Note 3. Loans and the Allowance for Loan Losses

The following is a summary of the balances in each segment of the Company’s loan portfolio:

	September 30, 2011	December 31, 2010
	(in thousands)	
Mortgage loans on real estate:		
Residential 1-4 family	$ 79,758	$ 89,690
Commercial	297,249	344,347
Construction	19,466	19,206
Second mortgages	14,939	16,105
Equity lines of credit	35,942	39,048
Total mortgage loans on real estate	447,354	508,396
Commercial loans	35,299	36,053
Consumer loans	18,356	24,389
Other	26,025	17,781
Total loans	527,034	586,619
Less: Allowance for loan losses	(9,752)	(13,228)
Loans, net of allowance and deferred fees	$ 517,282	$ 573,391

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Overdrawn deposit accounts are reclassified as loans and included in the Other category in the table above. Overdrawn deposit accounts totaled $601 thousand and $607 thousand at September 30, 2011 and December 31, 2010, respectively.

CREDIT QUALITY INFORMATION

The Company uses internally-assigned risk grades to estimate the capability of borrowers to repay the contractual obligations of their loan agreements as scheduled or at all. The Company's internal risk grade system is based on experiences with similarly graded loans. Credit risk grades are updated at least quarterly as additional information becomes available, at which time management analyzes the resulting scores to track loan performance.

The Company's internally assigned risk grades are as follows:

- Pass: Loans are of acceptable risk.
- Other Assets Especially Mentioned (OAEM): Loans have potential weaknesses that deserve management's close attention.
- Substandard: Loans reflect significant deficiencies due to several adverse trends of a financial, economic or managerial nature.
- Doubtful: Loans have all the weaknesses inherent in a substandard loan with added characteristics that make collection or liquidation in full based on currently existing facts, conditions and values highly questionable or improbable.
- Loss: Loans have been charged off because they are considered uncollectible and of such little value that their continuance as bankable assets is not warranted.

The following table presents credit quality exposures by internally assigned risk ratings:

Credit Quality Information
As of September 30, 2011
(in thousands)

	Pass	OAEM	Substandard	Doubtful	Total
Mortgage loans on real estate:					
Residential 1-4 family	$ 74,352	$ 683	$ 4,723	$ 0	$ 79,758
Commercial	276,652	2,627	17,970	0	297,249
Construction	18,970	399	97	0	19,466
Second mortgages	14,206	0	733	0	14,939
Equity lines of credit	35,079	162	701	0	35,942
Total mortgage loans on real estate	419,259	3,871	24,224	0	447,354
Commercial loans	34,538	346	415	0	35,299
Consumer loans	18,297	0	59	0	18,356
Other	26,025	0	0	0	26,025
Total	$ 498,119	$ 4,217	$ 24,698	$ 0	$ 527,034

Credit Quality Information
As of December 31, 2010
(in thousands)

	Pass	OAEM	Substandard	Doubtful	Total
Mortgage loans on real estate:					
Residential 1-4 family	$ 75,803	$ 2,383	$ 11,504	$ 0	$ 89,690
Commercial	287,551	23,969	30,000	2,827	344,347

Construction	18,052	0	1,154	0	19,206
Second mortgages	15,010	0	1,095	0	16,105
Equity lines of credit	37,206	1,109	733	0	39,048
Total mortgage loans on real estate	433,622	27,461	44,486	2,827	508,396
Commercial loans	33,275	2,179	599	0	36,053
Consumer loans	23,981	1	407	0	24,389
Other	17,693	87	1	0	17,781
Total	$ 508,571	$ 29,728	$ 45,493	$ 2,827	$ 586,619

As of September 30, 2011 and December 31, 2010 the Company did not have any loans internally classified as Loss.

AGE ANALYSIS OF PAST DUE LOANS BY CLASS

All classes of loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Interest and fees continue to accrue on past due loans until the date the loan is placed in nonaccrual status, if applicable. The following table includes an aging analysis of the recorded investment of past due loans. Also included in the table below are loans that are 90 days or more past due as to interest and principal and still accruing interest, either because they are (1) well-secured and in the process of collection or (2) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual. Loans in nonaccrual status that are also past due are included in the aging categories in the table below.

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Age Analysis of Past Due Loans at September 30, 2011

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 or More Days Past Due	Total Past Due (in thousands)	Total Current Loans (1)	Total Loans	Recorded Investment > 90 Days Past Due and Accruing
Mortgage loans on real estate:							
Residential 1-4 family	$ 808	$ 188	$ 965	$ 1,961	$ 77,797	$ 79,758	$ 175
Commercial	0	0	0	0	297,249	297,249	0
Construction	0	0	0	0	19,466	19,466	0
Second mortgages	0	358	119	477	14,462	14,939	0
Equity lines of credit	158	384	0	542	35,400	35,942	0
Total mortgage loans on real estate	966	930	1,084	2,980	444,374	447,354	175
Commercial loans	33	0	37	70	35,229	35,299	0
Consumer loans	56	9	15	80	18,276	18,356	15
Other	56	0	3	59	25,966	26,025	3
Total	$ 1,111	$ 939	$ 1,139	$ 3,189	$ 523,845	$ 527,034	$ 193

Age Analysis of Past Due Loans at December 31, 2010

	30 - 59 Days Past Due (in thousands)	60 - 89 Days Past Due	90 or More Days Past Due	Total Past Due	Total Current Loans (1)	Total Loans	Recorded Investment > 90 Days Past Due and Accruing
Mortgage loans on real estate:							
Residential 1-4 family	$ 1,550	$ 85	$ 1,641	$ 3,276	$ 86,414	$ 89,690	$ 0
Commercial	240	617	10,555	11,412	332,935	344,347	0
Construction	0	0	16	16	19,190	19,206	16
Second mortgages	475	0	187	662	15,443	16,105	33
Equity lines of credit	597	0	22	619	38,429	39,048	0
Total mortgage loans on real estate	2,862	702	12,421	15,985	492,411	508,396	49
Commercial loans	78	11	0	89	35,964	36,053	0
Consumer loans	297	49	69	415	23,974	24,389	23

Other	79	0	1	80	17,701	17,781	1
Total	$ 3,316	$ 762	$ 12,491	$ 16,569	$ 570,050	$ 586,619	$ 73

(1) For purposes of these tables, Total Current Loans includes loans that are 1 - 29 days past due.

NONACCRUAL LOANS

The Company generally places non-consumer loans in nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred or the loan reaches 90 days past due. Under regulatory rules, consumer loans, which are loans to individuals for household, family and other personal expenditures, and loans secured by 1-4 family residential properties are not required to be placed in nonaccrual status. Although consumer loans and loans secured by 1-4 family residential property are not required to be placed in nonaccrual status, the Company may place a consumer loan or loan secured by 1-4 family residential property in nonaccrual status, if necessary to avoid a material overstatement of interest income.

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Generally, consumer loans not secured by real estate or other collateral are placed in nonaccrual status only when part of the principal has been charged off. These loans are charged off or written down to the net realizable value of the collateral when deemed uncollectible, due to bankruptcy or other factors, or when they reach 90 days past due based on loan product, industry practice, terms and other factors.

When management places a loan in nonaccrual status, the accrued unpaid interest receivable is reversed against interest income and the loan is accounted for by the cash or cost recovery method, until it qualifies for return to accrual status. Generally, management returns a loan to accrual status if (a) all delinquent interest and principal become current under the terms of the loan agreement or (b) the loan is both well-secured and in the process of collection and collectability is no longer doubtful.

The following table presents loans in nonaccrual status by class of loan:

Nonaccrual Loans by Class

(in thousands)

	September 30, 2011	December 31, 2010
Mortgage loans on real estate:		
Residential 1-4 family	$ 3,105	$ 6,302
Commercial	8,218	13,281
Construction	0	37
Second mortgages	477	540
Equity lines of credit	384	427
Total mortgage loans on real estate	12,184	20,587
Commercial loans	151	178
Consumer loans	13	116
Total	$ 12,348	$ 20,881

The following table presents the interest income that the Company would have earned under the original terms of its nonaccrual loans and the actual interest recorded by the Company on nonaccrual loans for the period presented:

	Nine Months Ended September 30, 2011 (in thousands)
Interest income that would have been recorded under original loan terms	$ 1,202
Actual interest income recorded for the period	515
Reduction in interest income on nonaccrual loans	$ 687

MODIFICATIONS

The Company's loan portfolio also includes certain loans that have been modified in a Troubled Debt Restructuring (TDR), where economic concessions have been granted to borrowers who are experiencing financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reduction in the interest rate below current market rates, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months. When the Company modifies a loan, management evaluates any possible impairment as stated in the impaired loan section above.

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2011-02 “A Creditor’s Determination of Whether a Restructuring Is a Troubled Debt Restructuring” (ASU 2011-02). As a result of adopting ASU 2011-02, the Company reassessed all restructurings that occurred on or after January 1, 2011 to determine whether the restructurings are now considered TDRs. The Company identified as TDRs certain loans for which the allowance for loan losses had previously been measured under a general allowance methodology. Upon identifying those loans as TDRs, the Company classified those loans as impaired. ASU 2011-02 requires prospective application of the impairment measurement for those loans newly identified as impaired. As of September 30, 2011, the end of the first interim period of adoption, the recorded investment in loans for which the allowance was previously measured under a general allowance methodology and are now impaired was $2.0 million and the allowance for loan losses associated with those loans, on the basis of a current evaluation of the loss, was zero.

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The following table includes the number of modifications, the recorded investment before and after modification, and the current investment on September 30, 2011 for loans modified in a TDR, by class of loan:

Troubled Debt Restructurings by Class
At September 30, 2011
(dollars in thousands)

	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Current Investment on September 30, 2011
Mortgage loans on real estate:				
Residential 1-4 family	1	$ 175	$ 175	$ 175
Commercial	3	2,743	1,910	1,830
Construction	0	0	0	0
Second mortgages	1	10	10	10
Equity lines of credit	0	0	0	0
Total mortgage loans on real estate	5	2,928	2,095	2,015
Commercial loans	0	0	0	0
Consumer loans	0	0	0	0
Other	0	0	0	0
Total	5	$ 2,928	$ 2,095	$ 2,015

All loans in the table above are currently performing according to their modified terms and therefore are not included in the Company’s total nonperforming assets discussed elsewhere in this quarterly report.

The following tables present TDRs during the periods indicated, by class of loan:

Troubled Debt Restructurings by Class
For the Three Months Ended September 30, 2011
(dollars in thousands)

	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Current Investment on September 30, 2011
Mortgage loans on real estate:				
Residential 1-4 family	1	$ 175	$ 175	$ 175
Commercial	0	0	0	0
Construction	0	0	0	0
Second mortgages	1	10	10	10
Equity lines of credit	0	0	0	0
Total mortgage loans on real estate	2	185	185	185
Commercial loans	0	0	0	0
Consumer loans	0	0	0	0
Other	0	0	0	0
Total	2	$ 185	$ 185	$ 185

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Troubled Debt Restructurings by Class
For the Nine Months Ended September 30, 2011
(dollars in thousands)

	Number of Modifications	Recorded Investment Prior to Modification	Recorded Investment After Modification	Current Investment on September 30, 2011
Mortgage loans on real estate:				
Residential 1-4 family	1	$ 175	$ 175	$ 175
Commercial	1	362	260	257
Construction	0	0	0	0
Second mortgages	1	10	10	10
Equity lines of credit	0	0	0	0
Total mortgage loans on real estate	3	547	445	442
Commercial loans	0	0	0	0
Consumer loans	0	0	0	0
Other	0	0	0	0
Total	3	$ 547	$ 445	$ 442

Both the residential 1-4 family and the second mortgages loans were given interest rates below the current market for customers with similar risk profiles. The financial effects of these modifications can not be determined due to the fact that these loans would not have been made if the loans had not been restructurings of troubled loans already on the Company's books. The commercial real estate TDR was given a principal reduction of $102 thousand.

IMPAIRED LOANS

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans and loans modified in a troubled debt restructuring. When management identifies a loan as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole or remaining source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs when foreclosure is probable, instead of the discounted cash flows. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is in nonaccrual status, all payments are applied to principal under the cost-recovery method. For financial statement purposes, the recorded investment in the loan is the actual principal balance reduced by payments that would otherwise have been applied to interest. When reporting information on these loans to the applicable customers, the unpaid principal balance is reported as if payments were applied to principal and interest under the original terms of the loan agreements. Therefore, the unpaid principal balance reported to the customer would be higher than the recorded investment in the loan for financial statement purposes. When the ultimate collectability of the total principal of the impaired loan is not in doubt and the loan is in nonaccrual status, contractual interest is credited to interest income when received under the cash-basis method.

The following table includes the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount, if applicable. Also presented are the average recorded investments in the impaired loans and the related amount of interest recognized during 2010 and the first nine months of 2011. The average balances are calculated based on the month-end balance of the loans for the year ended December 31, 2010 and on the daily average balance for the nine months ended September 30, 2011.

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Impaired Loans by Class
(in thousands)

	As of September 30, 2011				Nine Months Ended September 30, 2011	
		Recorded Investment				
	Unpaid Principal Balance	Without Valuation Allowance	With Valuation Allowance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
Mortgage loans on real estate:						
Residential 1-4 family	$ 2,958	$ 674	$ 2,217	$ 186	$ 4,842	$ 546
Commercial	10,250	2,050	7,999	2,664	9,541	336
Construction	0	0	0	0	0	0
Second mortgages	497	106	381	31	498	14
Equity lines of credit	371	369	0	0	401	15
Total mortgage loans on real estate	$ 14,076	$ 3,199	$ 10,597	$ 2,881	$ 15,282	$ 911
Commercial loans	126	0	114	50	128	0
Total	$ 14,202	$ 3,199	$ 10,711	$ 2,931	$ 15,410	$ 911

Impaired Loans by Class
(in thousands)

	As of December 31, 2010				Year Ended December 31, 2010	
		Recorded Investment				
	Unpaid Principal Balance	Without Valuation Allowance	With Valuation Allowance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
Mortgage loans on real estate:						
Residential 1-4 family	$ 5,850	$ 5,008	$ 810	$ 70	$ 4,298	$ 320
Commercial	13,319	3,798	9,400	2,827	14,320	593
Construction	0	0	0	0	194	5
Second mortgages	508	100	404	62	377	33
Equity lines of credit	405	262	143	11	300	24
Total mortgage loans on real estate	$ 20,082	$ 9,168	$ 10,757	$ 2,970	$ 19,489	$ 975
Commercial loans	184	178	0	0	73	13
Total	$ 20,266	$ 9,346	$ 10,757	$ 2,970	$ 19,562	$ 988

MONITORING OF LOANS AND EFFECT OF MONITORING FOR THE ALLOWANCE FOR LOAN LOSSES
Loan officers are responsible for continual portfolio analysis and prompt identification and reporting of problem loans, which includes assigning a risk grade to each applicable loan at its origination and revising such grade as the situation dictates. Loan officers maintain frequent contact with borrowers, which should enable the loan officer to identify potential problems before other personnel. In addition, meetings with loan officers and upper management are held to discuss problem loans and review risk grades. Nonetheless, in order to avoid over-reliance upon loan officers for problem loan identification, the Bank's loan review system provides for review of loans and risk grades by

individuals who are independent of the loan approval process. Risk grades and historic loss rates by risk grades are used as a component of the calculation of the allowance for loan losses.

ALLOWANCE FOR LOAN LOSSES

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: commercial, real estate-construction, real estate-mortgage, consumer and other loans. The Company also sub-segments the real estate-mortgage segment into four classes: residential 1-4 family, commercial real estate, second mortgages and equity lines of credit. The Company uses an internally developed risk evaluation model in the estimation of the credit risk process. The model and assumptions used to determine the allowance are independently validated and reviewed to ensure that the theoretical foundation, assumptions, data integrity, computational processes and reporting practices are appropriate and properly documented.

Each portfolio segment has risk characteristics as follows:

- Commercial: Commercial loans carry risks associated with the successful operation of a business or project, in addition to other risks associated with the ownership of a business. The repayment of these loans may be dependent upon the profitability and cash flows of the business. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time and cannot be appraised with as much precision.

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- Real estate-construction: Construction loans carry risks that the project will not be finished according to schedule, the project will not be finished according to budget and the value of the collateral may at any point in time be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor, who may or may not be the loan customer, may be unable to finish the construction project as planned because of financial pressure unrelated to the project.
- Real estate-mortgage: Residential mortgage loans and equity lines of credit carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral. Commercial real estate loans carry risks associated with the successful operation of a business if owner occupied. If non-owner occupied, the repayment of these loans may be dependent upon the profitability and cash flow from rent receipts.
- Consumer loans: Consumer loans carry risks associated with the continued credit-worthiness of the borrowers and the value of the collateral. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.
- Other loans: Other loans are loans to mortgage companies, loans for purchasing or carrying securities, and loans to insurance, investment and finance companies. These loans carry risks associated with the successful operation of a business. In addition, there is risk associated with the value of collateral other than real estate which may depreciate over time, may depend on interest rates or may fluctuate in active trading markets.

To determine the balance of the allowance account for each segment of the loan portfolio, management pools each segment by risk grade individually and applies a historical loss percentage. At September 30, 2011 and December 31, 2010, the historical loss percent was based on losses sustained in each segment of the portfolio over the previous eight quarters.

Management also provides an allocated component of the allowance for loans that are classified as impaired. An allocated allowance is established when the discounted value of future cash flows from the impaired loan (or the collateral value or observable market price of the impaired loan) is lower than the carrying value of that loan.

Based on credit risk assessments and management's analysis of qualitative factors, additional loss factors are applied to loan balances. These additional qualitative factors include: the economy, trends in growth, concentrations, changes in underwriting, changes in management and changes in the legal and regulatory environment.

THE COMPANY'S ESTIMATION PROCESS

See the Management's Discussion and Analysis in this quarterly report on Form 10-Q for further discussion of the components of the allowance for loan losses.

ALLOWANCE FOR LOAN LOSSES BY SEGMENT

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. The Company considers the allowance for loan losses of $9.8 million adequate to cover loan losses inherent in the loan portfolio at September 30, 2011. The following table presents, by portfolio segment, the changes in the allowance for loan losses and the recorded investment in loans. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

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ALLOWANCE FOR LOAN LOSSES AND RECORDED INVESTMENT IN LOANS
(in thousands)

September 30, 2011	Commercial	Real Estate - Construction	Real Estate - Mortgage	Consumer	Other	Total
Allowance for Loan Losses:						
Balance at the beginning of period	$ 799	$ 441	$ 11,498	$ 357	$ 133	$ 13,228
Charge-offs	(877)	0	(5,861)	(298)	(160)	(7,196)
Recoveries	133	0	561	91	35	820
Provision for loan losses	722	(78)	1,796	163	297	2,900
Ending balance	$ 777	$ 363	$ 7,994	$ 313	$ 305	$ 9,752
Ending balance individually evaluated for impairment	$ 50	$ 0	$ 2,881	$ 0	$ 0	$ 2,931
Ending balance collectively evaluated for impairment	727	363	5,113	313	305	6,821
Ending balance	$ 777	$ 363	$ 7,994	$ 313	$ 305	$ 9,752
Loan Balances:						
Ending balance individually evaluated for impairment	$ 114	$ 0	$ 13,796	$ 0	$ 0	$ 13,910
Ending balance collectively evaluated for impairment	35,185	19,466	414,092	18,356	26,025	513,124
Ending balance	$ 35,299	$ 19,466	$ 427,888	$ 18,356	$ 26,025	$ 527,034

December 31, 2010	Commercial	Real Estate - Construction	Real Estate - Mortgage	Consumer	Other	Total
Allowance for Loan Losses:						
Balance at the beginning of period	$ 935	$ 354	$ 5,552	$ 672	$ 351	$ 7,864
Charge-offs	(556)	(126)	(2,971)	(655)	(180)	(4,488)
Recoveries	192	0	636	155	69	1,052
Provision for loan losses	228	213	8,281	185	(107)	8,800
Ending balance	$ 799	$ 441	$ 11,498	$ 357	$ 133	$ 13,228
Ending balance individually evaluated for impairment	$ 0	$ 0	$ 2,970	$ 0	$ 0	$ 2,970
Ending balance collectively evaluated for impairment	799	441	8,528	357	133	10,258
Ending balance	$ 799	$ 441	$ 11,498	$ 357	$ 133	$ 13,228
Loan Balances:						

Ending balance individually evaluated for impairment	$ 178	$ 0	$ 19,925	$ 0	$ 0	$ 20,103
Ending balance collectively evaluated for impairment	35,875	19,206	469,265	24,389	17,781	566,516
Ending balance	$ 36,053	$ 19,206	$ 489,190	$ 24,389	$ 17,781	$ 586,619

CHANGES IN ACCOUNTING METHODOLOGY

There were no changes in the Company's accounting methodology for the allowance for loan losses during the quarter and nine months ended September 30, 2011.

Note 4. Share-Based Compensation

Share-based compensation arrangements include stock options, restricted stock awards, performance-based awards, stock appreciation rights and employee stock purchase plans. Accounting standards require all share-based payments to employees to be valued using a fair value method on the date of grant and to be expensed based on that fair value over the applicable vesting period.

There were no options granted in the first nine months of 2011 or in 2010.

On March 9, 2008, the Company's 1998 Stock Option Plan expired. Options to purchase 165,710 shares of common stock were outstanding under the Company's 1998 Stock Option Plan at September 30, 2011. The exercise price of each option equals the market price of the Company's common stock on the date of the grant and each option's maximum term is ten years.

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Stock option activity for the nine months ended September 30, 2011 is summarized below:

	Shares		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)		Aggregate Intrinsic Value (in thousands)
Options outstanding, January 1, 2011	225,127	$	19.62			
Granted	0		0			
Exercised	(22,020)		12.91			
Canceled or expired	(37,397)		14.66			
Options outstanding, September 30, 2011	165,710	$	21.64	4.71	$	0
Options exercisable, September 30, 2011	127,226	$	22.12	4.30	$	0

The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on September 30, 2011.This amount changes based on changes in the market value of the Company's common stock. As of September 30, 2011, the outstanding options had no intrinsic value because the exercise prices of all outstanding options were above the market value of a share of the Company's common stock.

No in-the-money options were exercised during the nine months ended September 30, 2011. However, six option-holders chose to exercise options where the option price was greater than the current market value. Proceeds from these exercises were $284 thousand.

As of September 30, 2011, there was $109 thousand of unrecognized compensation cost related to nonvested options. This cost is expected to be recognized over a weighted-average period of 12 months.

Note 5. Pension Plan

The Company provides pension benefits for eligible participants through a non-contributory defined benefit pension plan. The plan was frozen effective September 30, 2006; therefore, no additional participants will be added to the plan. The components of net periodic pension plan cost are as follows:

Three months ended September 30,		2011		2010
		Pension Benefits		
Interest cost	$	76,031	$	78,430
Expected return on plan assets		(104,964)		(97,295)
Amortization of net loss		42,585		31,702
Net periodic pension plan cost	$	13,652	$	12,837

Nine months ended September 30,		2011		2010
		Pension Benefits		
Interest cost	$	228,095	$	235,292
Expected return on plan assets		(314,893)		(291,886)
Amortization of net loss		127,756		95,105
Net periodic pension plan cost	$	40,958	$	38,511

At September 30, 2011, management had not yet determined the amount, if any, that the Company will contribute to the plan in the year ending December 31, 2011.

Note 6. Earnings per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period. Diluted earnings per share is computed using the weighted average number of common shares outstanding during the period, including the effect of dilutive potential common shares attributable to outstanding stock options.

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The Company did not include an average of 198 thousand potential common shares attributable to outstanding stock options in the diluted earnings per share calculation for the first nine months of 2011 because they were antidilutive.

Note 7. Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, "Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements." ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In July 2010, the FASB issued ASU 2010-20, "Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." The new disclosure guidance significantly expands the existing requirements and will lead to greater transparency into a company's exposure to credit losses from lending arrangements. The extensive new disclosures of information as of the end of a reporting period became effective for both interim and annual reporting periods ending on or after December 15, 2010. Specific disclosures regarding activity that occurred before the issuance of the ASU, such as the allowance roll forward and modification disclosures, will be required for periods beginning on or after December 15, 2010. The Company has included the required disclosures in its consolidated financial statements.

In December 2010, the FASB issued ASU 2010-28, "Intangibles – Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts." The amendments in this ASU modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In December 2010, the FASB issued ASU 2010-29, "Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations." The guidance requires pro forma disclosure for business combinations that occurred in the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. If comparative financial statements are presented, the pro forma information should be reported as though the acquisition date for all business combinations that occurred during the current year had been as of the beginning of the comparable prior annual reporting period. ASU 2010-29 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

The SEC has issued Final Rule No. 33-9002, "Interactive Data to Improve Financial Reporting", which requires companies to submit financial statements in extensible business reporting language (XBRL) format with their SEC filings on a phased-in schedule. Large accelerated filers and foreign large accelerated filers using U.S. GAAP were required to provide interactive data reports starting with their first quarterly report for fiscal periods ending on or after June 15, 2010. All remaining filers are required to provide interactive data reports starting with their first quarterly report for fiscal periods ending on or after June 15, 2011. The Company complied with this Rule beginning with the filing of its June 30, 2011 quarterly report on Form 10-Q.

In March 2011, the SEC issued Staff Accounting Bulletin (SAB) 114. This SAB revises or rescinds portions of the interpretive guidance included in the codification of the Staff Accounting Bulletin Series. This update is intended to make the relevant interpretive guidance consistent with current authoritative accounting guidance issued as a part of the FASB's Codification. The principal changes involve revision or removal of accounting guidance references and other conforming changes to ensure consistency of referencing through the SAB Series. The effective date for SAB 114 is March 28, 2011. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

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In April 2011, the FASB issued ASU 2011-02, "Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring." The amendments in this ASU clarify the guidance on a creditor's evaluation of whether it has granted a concession to a debtor. The amendments also clarify the guidance on a creditor's evaluation of whether a debtor is experiencing financial difficulty. The amendments in this ASU are effective for the first interim or annual period beginning on or after June 15, 2011. Early adoption is permitted. Retrospective application to the beginning of the annual period of adoption for modifications occurring on or after the beginning of the annual adoption period is required. As a result of applying these amendments, an entity may identify receivables that are newly considered to be impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company has adopted ASU 2011-02 and included the required disclosure in its consolidated financial statements.

In April 2011, the FASB issued ASU 2011-03, "Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements." The amendments in this ASU remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee and (2) the collateral maintenance implementation guidance related to that criterion. The amendments in this ASU are effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The Company is currently assessing the impact that ASU 2011-03 will have on its consolidated financial statements.

In May 2011, the FASB issued ASU 2011-04, "Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (IFRSs)." This ASU is the result of joint efforts by the FASB and International Accounting Standards Board (IASB) to develop a single, converged fair value framework on how (not when) to measure fair value and what disclosures to provide about fair value measurements. The ASU is largely consistent with existing fair value measurement principles in U.S. GAAP (Topic 820), with many of the amendments made to eliminate unnecessary wording differences between U.S. GAAP and IFRSs. The amendments are effective for interim and annual periods beginning after December 15, 2011 with prospective application. Early application is not permitted. The Company is currently assessing the impact that ASU 2011-04 will have on its consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, "Comprehensive Income (Topic 220): Presentation of Comprehensive Income." The objective of this ASU is to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The single statement of comprehensive income should include the components of net income, a total for net income, the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present all the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. The amendments do not change the items that must be reported in other comprehensive income, the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects, or the calculation or reporting of earnings per share. The amendments in this ASU should be applied retrospectively. The amendments are effective for fiscal years and interim periods within those years beginning after December 15, 2011. Early adoption is permitted because compliance with the amendments is already permitted. The amendments do not require transition disclosures. The Company is currently assessing the impact that ASU 2011-05 will have on its consolidated financial statements.

In August 2011, the SEC issued Final Rule No. 33-9250, "Technical Amendments to Commission Rules and Forms related to the FASB's Accounting Standards Codification." The SEC has adopted technical amendments to various rules and forms under the Securities Act of 1933 (Securities Act), the Securities Exchange Act of 1934 (Exchange Act) and the Investment Company Act of 1940 (Investment Company Act). These revisions were necessary to conform those rules and forms to the FASB Accounting Standards Codification. The technical amendments include revision of certain rules in Regulation S-X, certain items in Regulation S-K, and various rules and forms prescribed under the Securities Act, Exchange Act and Investment Company Act. The rule was effective as of August 12, 2011. The adoption of the rule did not have a material impact on the Company's consolidated financial statements.

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In September 2011, the FASB issued ASU 2011-08, "Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment." The amendments in this ASU permit an entity to first assess qualitative factors related to goodwill to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this ASU, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this ASU are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The Company is currently assessing the impact that ASU 2011-08 will have on its consolidated financial statements.

Note 8. Fair Value Measurements
The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the Fair Value Measurements and Disclosures topic of FASB ASU 2010-06, the fair value of a financial instrument is the price that would be received in the sale of an asset or transfer of a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimate of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

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

FAIR VALUE HIERARCHY
In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 – Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 – Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 –

Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

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A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

ASSETS MEASURED AT FAIR VALUE ON A RECURRING BASIS

Debt and equity securities with readily determinable fair values are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2). In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Currently, all of the Company's available-for-sale securities are considered to be Level 2 securities.

The following table presents the balances of certain financial assets measured at fair value on a recurring basis:

		Fair Value Measurements at September 30, 2011 Using (in thousands)		
Description	Balance	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				
U.S. Treasury securities	$600	$0	$ 600	$ 0
Obligations of U.S. Government agencies	159,110	0	159,110	0
Obligations of state and political subdivisions	2,358	0	2,358	0
Mortgage-backed securities	46,342	0	46,342	0
Money market investments	938	0	938	0
Total available-for-sale securities	$209,348	$0	$ 209,348	$ 0

		Fair Value Measurements at December 31, 2010 Using (in thousands)		
Description	Balance	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				
U.S. Treasury securities	$600	$0	$600	$ 0
Obligations of U.S. Government agencies	200,121	0	200,121	0
Obligations of state and political subdivisions	3,172	0	3,172	0
Mortgage-backed securities	382	0	382	0
Money market investments	1,817	0	1,817	0
Total available-for-sale securities	$206,092	$0	$206,092	$ 0

ASSETS MEASURED AT FAIR VALUE ON A NONRECURRING BASIS

Under certain circumstances, adjustments are made to the fair value for assets and liabilities although they are not measured at fair value on an ongoing basis.

Impaired loans

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

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Foreclosed assets

Loans are transferred to foreclosed assets when the collateral securing them is foreclosed on. The measurement of loss associated with foreclosed assets is based on the fair value of the collateral compared to the unpaid loan balance and anticipated costs to sell the property. If there is a contract for the sale of a property, and management reasonably believes the transaction will be consummated in accordance with the terms of the contract, fair value is based on the sale price in that contract (Level 1). Lacking such a contract, the value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value is considered Level 3. Any fair value adjustments to foreclosed assets are recorded in the period incurred and expensed against current earnings.

The following table presents the financial instruments carried on the consolidated balance sheets by caption and by level in the fair value hierarchy for which a nonrecurring change in fair value has been recorded:

		Carrying Value at September 30, 2011 (in thousands)		
Description	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans	$7,780	$0	$5,852	$ 1,928
Foreclosed assets	$11,038	$847	$10,191	$ 0

		Carrying Value at December 31, 2010 (in thousands)		
Description	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Impaired loans	$7,787	$523	$6,182	$ 1,082
Foreclosed assets	$11,448	$0	$11,448	$ 0

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

CASH AND CASH EQUIVALENTS

The carrying amounts of cash and short-term instruments, including interest-bearing due from banks, approximate fair values.

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INVESTMENT SECURITIES
Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Securities are classified as Level 2 if quoted market prices are not available. Fair value is estimated using pricing models and discounted cash flows that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes and credit spreads. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified in Level 3.

RESTRICTED SECURITIES
The restricted security category is comprised of FHLB and FRB stock. These stocks are classified as restricted securities because their ownership is restricted to certain types of entities and they lack a market. Therefore, the carrying amounts of restricted securities approximate fair value.

LOANS RECEIVABLE
For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (e.g., 1-4 family residential), credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial and industrial loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

BANK-OWNED LIFE INSURANCE
Bank-owned life insurance represents insurance policies on certain officers of the Company. The cash value of the policies is estimated using information provided by the insurance carrier. These policies are carried at their cash value, which approximates the fair value.

DEPOSIT LIABILITIES
The fair value of demand deposits, savings and certain money market deposits is the amount payable on demand at the reporting date. The fair value of certificates of deposits is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities.

SHORT-TERM BORROWINGS
The carrying amounts of federal funds purchased, overnight repurchase agreements, and other short-term borrowings maturing within 90 days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

LONG-TERM BORROWINGS
The fair values of the Company's long-term borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

ACCRUED INTEREST
The carrying amounts of accrued interest approximate fair value.

COMMITMENTS TO EXTEND CREDIT AND IRREVOCABLE LETTERS OF CREDIT
The fair value of commitments is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit-worthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the

committed rates. The fair value of letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At September 30, 2011 and December 31, 2010, the fair value of fees charged for loan commitments and irrevocable letters of credit was immaterial.

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The estimated fair values, and related carrying or notional amounts, of the Company's financial instruments are as follows:

	September 30, 2011 Carrying Amount	September 30, 2011 Fair Value	December 31, 2010 Carrying Amount	December 31, 2010 Fair Value
	(in thousands)			
Financial assets:				
Cash and cash equivalents	$46,520	$46,520	$28,431	$28,431
Securities available-for-sale	209,348	209,348	206,092	206,092
Securities held-to-maturity	2,252	2,272	1,952	1,957
Restricted securities	3,679	3,679	4,320	4,320
Loans, net of allowances for loan losses	517,282	516,842	573,391	571,906
Bank owned life insurance	21,383	21,383	18,020	18,020
Accrued interest receivable	2,431	2,431	2,652	2,652
Financial liabilities:				
Deposits	$690,402	$692,344	$679,214	$682,001
Federal funds purchased and other borrowings	619	619	731	731
Overnight repurchase agreements	37,877	37,877	50,757	50,757
Term repurchase agreements	1,916	1,916	38,959	38,955
Federal Home Loan Bank advances	35,000	39,602	35,000	39,260
Accrued interest payable	603	603	824	824

Note 9. Segment Reporting

The Company operates in a decentralized fashion in three principal business segments: The Old Point National Bank of Phoebus (the Bank), Old Point Trust & Financial Services, N. A. (Trust), and the Company as a separate segment (for purposes of this Note, the Parent). Revenues from the Bank’s operations consist primarily of interest earned on loans and investment securities and service charges on deposit accounts. Trust’s operating revenues consist principally of income from fiduciary activities. The Parent’s revenues are mainly interest and dividends received from the Bank and Trust companies. The Company has no other segments.

The Company’s reportable segments are strategic business units that offer different products and services. They are managed separately because each segment appeals to different markets and, accordingly, requires different technologies and marketing strategies.

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Information about reportable segments, and reconciliation of such information to the consolidated financial statements as of and for the three and nine months ended September 30, 2011 and 2010 follows:

	Three Months Ended September 30, 2011				
	Bank	Trust	Unconsolidated Parent	Eliminations	Consolidated
Revenues					
Interest and dividend income	$8,980,855	$10,139	$ 1,134,786	$(1,133,857)	$8,991,923
Income from fiduciary activities	0	713,946	0	0	713,946
Other income	2,437,145	65,431	75,000	(90,776)	2,486,800
Total operating income	11,418,000	789,516	1,209,786	(1,224,633)	12,192,669
Expenses					
Interest expense	1,619,245	0	3,089	(3,301)	1,619,033
Provision for loan losses	600,000	0	0	0	600,000
Salaries and employee benefits	4,195,687	510,582	128,481	0	4,834,750
Other expenses	3,500,412	223,337	70,787	(90,776)	3,703,760
Total operating expenses	9,915,344	733,919	202,357	(94,077)	10,757,543
Income before taxes	1,502,656	55,597	1,007,429	(1,130,556)	1,435,126
Income tax expense (benefit)	408,793	18,904	(35,850)	0	391,847
Net income	$1,093,863	$36,693	$ 1,043,279	$(1,130,556)	$1,043,279
Total assets	$848,274,180	$4,882,446	$ 85,589,149	$(86,177,039)	$852,568,736

	Three Months Ended September 30, 2010				
	Bank	Trust	Unconsolidated Parent	Eliminations	Consolidated
Revenues					
Interest and dividend income	$ 10,159,276	$ 12,515	$ 1,127,461	$ (1,126,829)	$ 10,172,423
Income from fiduciary activities	0	718,008	0		