REPORT OF INDEPENDENT AUDITORS AND
CONSOLIDATED FINANCIAL STATEMENTS

DENALI BANCORPORATION, INC. AND SUBSIDIARY

December 31, 2017 and 2016

MOSSADAMS

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Note: These financial statements have not been reviewed or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

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Report of Independent Auditors

To the Stockholders and Board of Directors
Denali Bancorporation, Inc. and Subsidiary

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Denali Bancorporation, Inc. and Subsidiary (the Company), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 Denali Bancorporation, Inc. and Subsidiary as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Portland, Oregon
March 23, 2018

	December 31, 2017	December 31, 2016
ASSETS		
Cash and due from banks	$ 3,153,026	$ 3,341,696
Interest-bearing deposits in other financial institutions	4,849,767	10,856,929
Investment securities available-for-sale, at fair value	71,047,304	82,570,561
Investment securities held-to-maturity, at amortized cost	13,387,658	15,184,981
Loans held-for-sale	1,050,354	269,447
Loans, net of allowance for loan losses and unearned income	160,565,082	142,096,555
Accrued interest receivable	1,193,327	1,169,021
Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	5,073,111	5,354,118
Federal Home Loan Bank stock	344,300	324,200
Cash surrender value of bank-owned life insurance	6,368,139	6,186,129
Other real estate owned	1,810,350	1,995,507
Other assets	839,231	846,182
Total assets	$ 269,681,649	$ 270,195,326
LIABILITIES		
Deposits		
Noninterest-bearing demand deposits	$ 98,359,746	$ 100,303,178
Interest-bearing demand deposits	27,008,765	26,646,840
Savings	79,816,058	86,294,743
Time deposits	33,624,031	26,881,399
Total deposits	238,808,600	240,126,160
Dividends payable	1,706,317	1,702,177
Federal Home Loan Bank advances	500,000	-
Accrued interest payable and other liabilities	535,476	722,447
Total liabilities	241,550,393	242,550,784
COMMITMENTS AND CONTINGENCIES (NOTE 9)		
STOCKHOLDERS' EQUITY		
Common stock $1 par value; 10,000,000 shares authorized; 2,843,861 and 2,836,961 shares issued and outstanding at December 31, 2017 and 2016, respectively	2,843,861	2,836,961
Additional paid-in capital	5,360,807	5,303,881
Retained earnings	18,864,054	18,740,905
Accumulated other comprehensive income, net of taxes	1,062,534	762,795
Total stockholders' equity	28,131,256	27,644,542
Total liabilities and stockholders' equity	$ 269,681,649	$ 270,195,326
BOOK VALUE PER SHARE OF COMMON STOCK	$ 9.89	$ 9.74

See accompanying notes.

Denali Bancorporation, Inc. and Subsidiary
Consolidated Statements of Income

	Years Ended December 31, 2017	Years Ended December 31, 2016
INTEREST INCOME		
Interest and fees on loans	$ 9,072,250	$ 8,687,417
Interest on investment securities	2,552,593	2,663,709
Interest on deposits at other financial institutions	93,131	66,425
Total interest income	11,717,974	11,417,551
INTEREST EXPENSE		
Interest on deposits	318,168	310,953
Interest on borrowed funds	17,125	19,036
Total interest expense	335,293	329,989
NET INTEREST INCOME	11,382,681	11,087,562
PROVISION FOR LOAN LOSSES	560,000	56,100
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	10,822,681	11,031,462
NONINTEREST INCOME		
Service charges and other fees	2,110,105	2,007,356
Net gain on sale of loans	508,568	670,183
Net gain on sale of investment securities	57,848	375,586
Increase in value of bank-owned life insurance	182,010	186,129
Total noninterest income	2,858,531	3,239,254
NONINTEREST EXPENSE		
Salaries and employee benefits	6,955,956	7,059,955
Net occupancy and equipment	1,150,635	1,185,146
Data processing and telephone	1,033,074	1,071,302
Professional fees	300,392	341,572
Bankcard processing	279,585	318,326
Advertising and promotion	254,346	181,164
Regulatory assessments	86,202	122,565
Other operating expenses	1,418,825	1,290,799
Total noninterest expense	11,479,015	11,570,829
INCOME BEFORE PROVISION FOR INCOME TAXES	2,202,197	2,699,887
PROVISION FOR INCOME TAXES	197,884	373,891
NET INCOME	$ 2,004,313	$ 2,325,996
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING	2,843,577	2,836,961
BASIC EARNINGS PER SHARE OF COMMON STOCK	$ 0.70	$ 0.82

See accompanying notes.

Consolidated Statements of Comprehensive Income

	Years Ended December 31, 2017	2016
NET INCOME	$ 2,004,313	$ 2,325,996
OTHER COMPREHENSIVE INCOME (LOSS)		
Change in unrealized gain on investment securities available-for-sale, net of taxes of $83,696 and ($488,530)	159,485	(726,566)
Reclassification adjustment for realized gains on investment securities available-for-sale included in net income, net of taxes of $23,255 and $150,986	(34,593)	(224,600)
Total other comprehensive income (loss), net of taxes	124,892	(951,166)
COMPREHENSIVE INCOME	$ 2,129,205	$ 1,374,830

Consolidated Statements of Changes in Stockholders' Equity

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	Common Stock Shares	Common Stock Amount	Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
BALANCE, December 31, 2015	2,836,961	$ 2,836,961	$ 5,303,881	$ 18,117,086	$ 1,713,961	$ 27,971,889
Net income	-	-	-	2,325,996	-	2,325,996
Other comprehensive loss, net of taxes	-	-	-	-	(951,166)	(951,166)
Cash dividend ($0.60 per share)	-	-	-	(1,702,177)	-	(1,702,177)
BALANCE, December 31, 2016	2,836,961	2,836,961	5,303,881	18,740,905	762,795	27,644,542
Net income	-	-	-	2,004,313	-	2,004,313
Other comprehensive income, net of taxes	-	-	-	-	124,892	124,892
Reclassification of certain income tax effects of items within accumulated other comprehensive income	-	-	-	(174,847)	174,847	-
Directors' fees paid in common stock	6,900	6,900	56,926	-	-	63,826
Cash dividend ($0.60 per share)	-	-	-	(1,706,317)	-	(1,706,317)
BALANCE, December 31, 2017	2,843,861	$ 2,843,861	$ 5,360,807	$ 18,864,054	$ 1,062,534	$ 28,131,256

Denali Bancorporation, Inc. and Subsidiary
Consolidated Statements of Cash Flows

	Years Ended December 31, 2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 2,004,313	$ 2,325,996
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	560,000	56,100
Depreciation and amortization	498,350	573,381
Amortization of premiums/accretion of discounts on investment securities	1,480,141	1,523,512
Net gain on sale of investment securities available-for-sale	(57,848)	(375,586)
Loss on sale of other real estate owned	19,647	-
Gain on sale of premises, equipment, and leasehold improvements	-	(1,775)
Directors’ fees paid with common stock	63,826	-
Change in deferred loan fees and costs	55,558	39,685
Change in deferred taxes	(62,220)	(306,302)
Proceeds from sale of loans held-for-sale	17,805,207	23,928,660
Originations of loans held-for-sale	(18,077,546)	(22,817,175)
Net gain on sale of loans	(508,568)	(670,183)
Increase in value of bank-owned life insurance	(182,010)	(186,129)
Changes in cash due to changes in certain assets and liabilities:		
Accrued interest receivable	(24,306)	71,602
Other assets	(14,798)	534,607
Accrued interest payable and other liabilities	(186,971)	(150,059)
Net cash from operating activities	3,372,775	4,546,334
CASH FLOWS FROM INVESTING ACTIVITIES		
Net change in interest-bearing deposits in other financial institutions	6,007,162	(7,348,936)
Purchases of available-for-sale securities	(10,613,851)	(14,975,620)
Proceeds from sale of available-for-sale securities	2,868,442	6,168,363
Proceeds from calls and maturities of available-for-sale securities	18,144,570	13,522,719
Purchases of held-to-maturity securities	-	(509,167)
Proceeds from calls and maturities of held-to-maturity securities	1,707,987	1,108,061
Net (increase) decrease in loans	(19,084,085)	5,493,767
Proceeds from sale of other real estate owned	165,510	-
(Purchases) redemptions of Federal Home Loan Bank stock	(20,100)	154,900
Payments made for purchase of premises, equipment, and leasehold improvements	(217,343)	(716,910)
Proceeds received from the sale of premises, equipment, and leasehold improvements	-	1,775
Purchases of bank-owned life insurance	-	(6,000,000)
Net cash from investing activities	(1,041,708)	(3,101,048)

See accompanying notes.

	Years Ended December 31, 2017	2016
CASH FLOWS FROM FINANCING ACTIVITIES		
Net (decrease) increase in demand deposit and savings accounts	$ (8,060,192)	$ 10,415,999
Net increase (decrease) in time deposits	6,742,632	(6,093,892)
Federal Home Loan Bank borrowings advanced	500,000	-
Federal Home Loan Bank borrowings repaid	-	(4,000,000)
Cash dividends paid	(1,702,177)	(1,499,837)
Net cash from financing activities	(2,519,737)	(1,177,730)
NET CHANGE IN CASH AND CASH EQUIVALENTS	(188,670)	267,556
CASH AND CASH EQUIVALENTS, beginning of year	3,341,696	3,074,140
CASH AND CASH EQUIVALENTS, end of year	$ 3,153,026	$ 3,341,696
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid for interest	$ 323,920	$ 327,116
Cash paid for income taxes	$ 520,000	$ 616,000
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Change in fair value of securities included in accumulated other comprehensive income, net of tax	$ 124,892	$ (951,166)
Transfer of loans to other real estate owned	$ -	$ 1,995,507
Dividends declared but unpaid	$ 1,706,317	$ 1,702,177

See accompanying notes.

Note 1 – Organization and Summary of Significant Accounting Policies

Organization

Denali Bancorporation, Inc. (the Company) is a bank holding company whose principal activity is the ownership and operation of its wholly-owned subsidiary, Denali State Bank (the Bank). The Bank generates commercial, consumer, construction and mortgage loans, and receives deposits from customers located primarily in Interior Alaska. The Bank is chartered and regulated by the State of Alaska and is insured and subject to regulation by the Federal Deposit Insurance Corporation.

Basis of presentation

The accompanying consolidated financial statements of Denali Bancorporation, Inc. include the accounts of the Company and its wholly-owned subsidiary, Denali State Bank. Significant intercompany transactions and balances have been eliminated in the preparation of the consolidated financial statements.

Financial statement presentation and use of estimates

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles and reporting practices applicable to the banking industry. The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the reported amounts of income and expenses during the reporting period. Actual results could differ significantly from those estimates.

Significant estimates are necessary in determining the recorded value of the allowance for loan losses, fair values and impairment of investment securities, fair value of impaired loans, net realizable value of other real estate owned, and fair values of financial instruments. Management believes the assumptions used in arriving at these estimates are appropriate.

Comprehensive income

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of stockholders' equity and within the consolidated statements of comprehensive income.

Cash and cash equivalents

Cash equivalents are generally short-term investments with a maturity of three months or less. Cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold.

The Bank maintains balances in correspondent bank accounts which, at times, may exceed federally insured limits. Management believes that its risk of loss associated with such balances is minimal due to the financial strength of correspondent banks. The Bank has not experienced any losses in such accounts.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Investment securities
Debt securities that management has the positive intent and ability to hold to maturity are classified as “held-to-maturity” and recorded at amortized cost. Securities are classified as “available-for-sale” if the instrument may be sold in response to such factors as: (1) changes in market interest rates and related changes in prepayment risk, (2) needs for liquidity, (3) changes in the availability of and the yield on alternative instruments, and (4) changes in funding sources and terms. Gains or losses on the sale of available-for-sale securities are determined using the specific-identification method. Unrealized holding gains and losses, net of tax, on available-for-sale securities are carried as accumulated other comprehensive income or loss within stockholders’ equity until realized. Fair values for these investment securities are generally based on quoted market prices for the same or similar instruments. Premiums and discounts for all investment securities are recognized in interest income using the effective interest method over the period to maturity for the accretion of discounts and until the most recent call date for securities purchased at a premium.

Investment securities are reviewed on an ongoing basis for the presence of other-than-temporary impairment (OTTI) or permanent impairment, taking into consideration current market conditions, fair value in relationship to cost, extent, and nature of the change in fair value, issuer rating changes and trends, whether the Bank intends to sell a security or if it is likely that it will be required to sell the security before recovery of its amortized cost basis of the investment, which may be maturity, and other factors. For debt securities, if the Bank intends to sell the security or it is likely that it 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 Bank does not intend to sell the security and it is not likely that it will be required to sell the security, but it does 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) within stockholders’ equity.

Securities transferred from held-to-maturity to available-for-sale are transferred at amortized cost and subsequently adjusted to fair value at the date of transfer. Fair value adjustments are recognized in other comprehensive income at the time of the transfer and, thereafter, among unrealized gains or losses recognized for all securities classified as available-for-sale.

Loans, net of allowance for loan losses and unearned income
Loans are stated at their unpaid principal balances, net of premiums and discounts on purchased loans, the allowance for loan losses and unamortized deferred fees and costs. All loan origination fees and related direct costs are deferred and amortized to interest income as an adjustment to yield over the respective maturities of the loans using the effective interest method. Interest on loans is accrued as earned on a daily basis based on principal amounts outstanding, except where reasonable doubt exists as to the collection of interest, in which case the accrual of interest is discontinued and the loan is placed on non-accrual status.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

A loan is considered to be impaired when, based on current information and events, it is probable that the Bank will not be able to collect all amounts due (both principal and interest), according to the contractual terms of the loan agreement. Impaired loans are carried at the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's market price, or the fair value of the collateral if the loan is collateral dependent. Accrual of interest is discontinued on impaired loans when management believes, after considering economic and business conditions, collection efforts and collateral position, that the borrower's financial condition is such that collection of interest is doubtful. When interest accrual is discontinued, all unpaid accrued interest is reversed. Interest income is subsequently recognized only to the extent cash payments are received and collection of the principal amount of the loan is reasonably assured.

A troubled debt restructuring is a formal restructure of a loan in which the Bank, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower. The concession may be granted in various forms, including reduction in the stated interest rate, reduction in the loan balance or accrued interest, and extension of the maturity date. Troubled debt restructurings are measured at the time of restructure for impairment, and subsequently are subjected to the Bank's impaired loan accounting policy.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectability of principal is unlikely. Recoveries of previously charged-off loans are recorded as a credit or increase to the allowance for loan losses. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. Various regulatory agencies, as a routine part of their examination process, periodically review the Bank's reserve for loan losses. Such agencies may require the Bank to recognize additions to the allowance, based on their judgment of information available to them at the time of examinations.

Loans held-for-sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or estimated market value. Net unrealized losses are recognized in a valuation allowance by charges to income.

Transfers of financial assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Other real estate owned

Other real estate owned, which represents property acquired through foreclosure or deeds in lieu of foreclosure, is initially measured and carried at fair value, establishing a new cost basis. At the time of foreclosure, any excess of the loan balance over the fair value of the property is charged to the allowance for loan losses and any excess estimated fair value over the loan's carrying value is recognized first as a recovery to the allowance for loan losses, to the extent that amounts have been charged-off for that loan.

Subsequently, any carrying value in excess of the loan's fair value is recognized in noninterest expense. Subsequent write-downs to net realizable value, if any, or any disposition gains or losses are included in noninterest income and expense.

Premises, equipment, and leasehold improvements

Premises, equipment, and leasehold improvements are stated at cost, less accumulated depreciation, and amortization. Depreciation and amortization are computed principally by the straight-line method over the estimated useful lives of the assets, or lease term in the case of leasehold improvements, which range from three to forty years.

Federal Home Loan Bank (FHLB) of Des Moines stock

At December 31, 2017 and 2016, the Bank held FHLB stock with a par value of $344,300 and $324,200, respectively. As a member of the FHLB system, the Bank is required to maintain a minimum investment level in FHLB stock, based on specific percentages of the Bank's outstanding mortgages, total assets, or FHLB advances. This security is reported at par value, which represents the Bank's cost. Stock redemptions are made at the discretion of the FHLB.

Stock in the FHLB of Des Moines is classified as restricted stock and is periodically evaluated for impairment. The determination as to whether the investment is impaired is based on the Bank's assessment of the ultimate recoverability of par value rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (1) the significance of the decline in the net assets of the FHLB as compared to the capital stock of 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 the legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB, and (4) the liquidity position of the FHLB. Management's review for impairment is based on ultimate recoverability of the Bank's cost basis in FHLB stock, and concluded that the FHLB stock investment was not impaired as of December 31, 2017.

Cash surrender value of bank-owned life insurance

The Bank holds life insurance contracts covering certain executives and senior management. The cash surrender values of the contracts reflect the Bank's investment in the recorded assets, net of surrender charges. Holding gains and losses related to the contracts are included in earnings as gains or losses in the period in which they arise.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Income taxes
Income taxes are accounted for using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement and tax basis of assets and liabilities at the applicable enacted tax rates. A valuation allowance is provided when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company evaluates the realizability of its deferred tax assets by assessing its valuation allowance and by adjusting the amount of such allowance, if necessary.

The Company recognizes the tax benefit from uncertain tax positions only if it is more likely than not that the tax positions will be sustained on examination by the taxing authorities, based on the technical merits of the position. A tax benefit is measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The Company does not anticipate that the amount of any unrecognized tax benefits will significantly increase or decrease in the next 12 months. The Company recognizes interest and penalties related to income tax matters in income tax expense.

The Company files income tax returns in the U.S. federal jurisdiction and the state of Alaska. The Company is no longer subject to U.S. or Alaska state examinations by tax authorities for years before 2014.

The Tax Cuts and Jobs Act of 2017 was enacted December 22, 2017, and changed the federal corporate tax rate to 21% from 34%, effective January 1, 2018, and preserved the full deductibility of state corporate taxes. Accordingly, the Company has recognized the effects of changes in tax laws and rates on the deferred tax assets and liabilities as of December 31, 2017 (see Note 8 – Income Taxes). The resulting adjustment of $11,732 to decrease the value of the net deferred tax asset was recognized by the Company in December 2017 as tax expense.

Off-balance sheet financial instruments
The Bank holds no derivative financial instruments. However, in the ordinary course of business, the Bank enters into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. These financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

Advertising and promotional expenses
The Bank expenses advertising and promotional costs as they are incurred. Advertising costs of $254,346 and $181,164 were charged to expense during the years ended December 31, 2017 and 2016, respectively.

Earnings per share
Basic earnings per common share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period, retroactively adjusted for stock dividends and splits. Diluted earnings per common share is computed similar to basic earnings per common share except that the denominator is increased, using the treasury stock method, to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Since the Company has no common stock equivalents outstanding as of December 31, 2017 and 2016, only basic earnings per share information is presented.

Fair value measurements
Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. The Bank determines fair value based upon quoted prices when available or through the use of alternative approaches, such as matrix or model pricing, when market quotes are not readily accessible or available. The valuation techniques used are based on observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Bank's market assumptions.

These two types of inputs create the following fair value hierarchy:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Bank used the following methods and significant assumptions to estimate fair value for its assets measured and carried at fair value on a recurring basis in the financial statements:

Investment securities available-for-sale – For these securities, the Bank obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. When market quotes are not readily accessible or available, alternative approaches are utilized, such as matrix or model pricing. The Company has determined these are Level 1, Level 2, and Level 3 inputs.

Impaired loans – Fair value of impaired loans is based upon the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's market price, or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. The Company has determined these are Level 3 inputs.

Other real estate owned – Certain assets held within other real estate owned represent impaired real estate that has been adjusted to its estimated fair value as a result of their transfer from the loan portfolio at the time of foreclosure and based on management's periodic impairment evaluation. The Company has determined these are Level 3 inputs.

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Reclassifications

Certain account reclassifications have been made to the financial statements of the prior year to conform to the current year presentation. These reclassifications have no effect on previously reported net income or stockholders' equity.

Events subsequent to year-end

Subsequent events are events or transactions that occur after the balance sheet date but before the consolidated financial statements are issued. The Company recognizes in the consolidated financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the consolidated financial statements. The Company's consolidated financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before consolidated financial statements are available to be issued. The Company has evaluated subsequent events through March 23, 2018, which is the date the consolidated financial statements became available to be issued.

Note 2 – Investment Securities

The amortized cost and estimated fair values of investments in debt securities are summarized as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2017				
Securities available-for-sale:				
Mortgage-backed securities	$ 33,226,761	$ 980,072	$ (183,775)	$ 34,023,058
Obligations of states and political subdivisions	32,837,223	839,901	(145,297)	33,531,827
Obligations of U.S. government corporations and agencies	3,498,794	1,439	(7,814)	3,492,419
	$ 69,562,778	$ 1,821,412	$ (336,886)	$ 71,047,304
Securities held-to-maturity:				
Obligations of states and political subdivisions	$ 12,209,019	$ 462,812	$ -	$ 12,671,831
Mortgage-backed securities	1,178,639	89,987	-	1,268,626
	$ 13,387,658	$ 552,799	$ -	$ 13,940,457
December 31, 2016				
Securities available-for-sale:				
Mortgage-backed securities	$ 38,625,531	$ 1,247,326	$ (235,475)	$ 39,637,382
Obligations of states and political subdivisions	33,607,759	681,378	(451,294)	33,837,843
Obligations of U.S. government corporations and agencies	7,063,428	31,076	(15,730)	7,078,774
Corporate securities	1,998,178	18,384	-	2,016,562
	$ 81,294,896	$ 1,978,164	$ (702,499)	$ 82,570,561
Securities held-to-maturity:				
Obligations of states and political subdivisions	$ 13,445,331	$ 451,825	$ (34,592)	$ 13,862,564
Mortgage-backed securities	1,739,650	124,061	-	1,863,711
	$ 15,184,981	$ 575,886	$ (34,592)	$ 15,726,275

Note 2 – Investment Securities (continued)

The following table presents the gross unrealized losses and fair values of the Bank's investment securities, aggregated by investment category and length of time that individual securities have been in continuous unrealized loss positions:

	Less than 12 Months		12 Months or More		Totals	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2017						
Securities available-for-sale						
Mortgage-backed securities	$ 6,500,869	$ (68,690)	$ 6,850,903	$ (115,085)	$ 13,351,772	$ (183,775)
Obligations of states and political subdivisions	1,928,902	(10,027)	3,965,965	(135,270)	5,894,867	(145,297)
Obligations of U.S. government corporations and agencies	2,974,704	(7,814)	-	-	2,974,704	(7,814)
	$ 11,404,475	$ (86,531)	$ 10,816,868	$ (250,355)	$ 22,221,343	$ (336,886)
December 31, 2016						
Securities available-for-sale						
Mortgage-backed securities	$ 7,036,376	$ (177,791)	$ 7,342,171	$ (57,684)	$ 14,378,547	$ (235,475)
Obligations of states and political subdivisions	10,763,777	(445,864)	951,092	(5,430)	11,714,869	(451,294)
Obligations of U.S. government corporations and agencies	19,949,960	(5,010)	1,989,280	(10,720)	21,939,240	(15,730)
	$ 37,750,113	$ (628,665)	$ 10,282,543	$ (73,834)	$ 48,032,656	$ (702,499)
Securities held-to-maturity						
Obligations of states and political subdivisions	$ 505,420	$ (3,660)	$ 1,107,810	$ (30,932)	$ 1,613,230	$ (34,592)

At December 31, 2017 and 2016, the Bank held 22 and 36 securities, respectively, that had unrealized losses and are considered to be temporarily impaired investments. Temporary impairment of these securities is due to interest rate risk associated with fixed-rate obligations and prepayment risk resulting from premature calls of similar classes of securities. Management believes that, while actual fluctuations in unrealized losses may occur over the life of investment securities, the temporary impairment of each investment security in an unrealized loss position at December 31, 2017 and 2016, will reverse as the individual investment security approaches its contractual maturity date, except as noted below.

There were no other-than-temporary impairment charges recognized during the years ended December 31, 2017 or 2016. In determining whether other material amounts of other-than-temporary impairment exist, management has considered the likelihood that securities will be called prior to maturity and the ability of the issuer to satisfy its repayment obligation upon maturity. Based on these and other considerations, management believes that no other material amounts of other-than-temporary impairment exist as of December 31, 2017 and 2016.

Note 2 – Investment Securities (continued)

The following table presents a rollforward of the credit loss component of available-for-sale securities that have been written down for other-than-temporary impairment (OTTI) with the credit loss component recognized in earnings and the remaining impairment loss related to all other factors recognized in other comprehensive income for the years ended December 31, 2017 and 2016:

	2017	2016
Balance of OTTI recognized, beginning of period	$ (364,355)	$ (401,365)
Reduction in OTTI for repayments of debt securities	44,085	37,010
Balance of OTTI recognized, end of period	$ (320,270)	$ (364,355)

At December 31, 2017 and 2016, securities with fair values of $19,523,744 and $19,701,563, respectively, were pledged to secure borrowings and public deposits, as required or permitted by law.

Proceeds from the sale of available-for-sale securities were $2,868,442 and $6,168,363 during 2017 and 2016, respectively. The sales resulted in gross realized gains of $75,227 and $388,719 for the years ended December 31, 2017 and 2016, respectively. Gross realized losses for the years ended December 31, 2017 and 2016 were $17,379 and $13,133, respectively.

The amortized cost and estimated fair value of available-for-sale and held-to-maturity investment securities by contractual maturity at December 31, 2017, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Securities Available-for-Sale		Securities Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 1,532,315	$ 1,525,986	$ 3,469,559	$ 3,514,083
Due after one year through five years	9,727,991	10,054,211	4,479,766	4,645,776
Due after five years through ten years	4,874,927	5,027,297	1,681,050	1,757,344
Due after ten years	53,427,545	54,439,810	3,757,283	4,023,254
	$ 69,562,778	$ 71,047,304	$ 13,387,658	$ 13,940,457

For the purposes of the maturity table above, mortgage-backed securities, which are not due at a single maturity date, have been allocated over maturity groupings based on the weighted-average contractual maturities of underlying collateral. Mortgage-backed securities may mature earlier than their weighted-average contractual maturities because of principal prepayments.

Note 3 – Loans, Net of Allowance for Loan Losses and Unearned Income

Loans consisted of the following at December 31:

	2017	2016
Commercial	$ 37,550,515	$ 25,209,080
Commercial real estate	71,818,443	74,346,622
Consumer	19,833,769	12,777,305
Residential	34,134,560	32,633,420
Total loans	163,337,287	144,966,427
Allowance for loan losses	(2,431,469)	(2,473,578)
Deferred loan fees and costs, net	(340,736)	(396,294)
Loans, net	$ 160,565,082	$ 142,096,555

Loans pledged to secure borrowings were approximately $72,954,933 and $80,742,326 as of December 31, 2017 and 2016, respectively.

Mortgage loans originated by the Bank are normally sold on a nonrecourse basis to the Alaska Housing Finance Corporation, the Federal Home Loan Mortgage Corporation (Freddie Mac), the Federal National Mortgage Association (Fannie Mae) and other secondary markets. At December 31, 2017 and 2016, the Bank serviced mortgage loans of $183,106,355 and $193,258,436, respectively, which had been sold to these investors.

Note 4 – Allowance for Loan Losses

The following tables display the allocation of, and activity within, the allowance for loan losses to significant segments of the loan portfolio as of and for the years ended December 31, 2017 and 2016:

	2017				
	Commercial	Commercial Real Estate	Consumer	Residential	Totals
Allowance					
Balance, beginning of the period	$ 859,000	$ 1,192,046	$ 334,170	$ 88,362	$ 2,473,578
Charge-offs	(171,346)	-	(468,767)	-	(640,113)
Recoveries	13,262	-	24,030	712	38,004
Provision for loan losses	-	-	510,000	50,000	560,000
Balance, end of the period	$ 700,916	$ 1,192,046	$ 399,433	$ 139,074	$ 2,431,469
Ending balance individually evaluated for impairment	$ 25,000	$ 13,675	$ 3,256	$ 105,471	$ 147,402
Ending balance collectively evaluated for impairment	$ 675,916	$ 1,178,371	$ 396,177	$ 33,603	$ 2,284,067
Loans					
Ending balance individually evaluated for impairment	$ 125,856	$ 594,885	$ 33,943	$ 825,398	$ 1,580,082
Ending balance collectively evaluated for impairment	$ 37,424,659	$ 71,223,558	$ 19,799,826	$ 33,309,162	$ 161,757,205
Total loans	$ 37,550,515	$ 71,818,443	$ 19,833,769	$ 34,134,560	$ 163,337,287

Note 4 – Allowance for Loan Losses (continued)

	2016				
	Commercial	Commercial Real Estate	Consumer	Residential	Totals
Allowance					
Balance, beginning of the period	$ 839,353	$ 1,192,046	$ 395,319	$ 120,077	$ 2,546,795
Charge-offs	(62,212)	-	(79,605)	(33,222)	(175,039)
Recoveries	25,759	-	18,456	1,507	45,722
Provision for loan losses	56,100	-	-	-	56,100
Balance, end of the period	$ 859,000	$ 1,192,046	$ 334,170	$ 88,362	$ 2,473,578
Ending balance individually evaluated for impairment	$ 272,057	$ 22,779	$ 1,653	$ 19,912	$ 316,401
Ending balance collectively evaluated for impairment	$ 586,943	$ 1,169,267	$ 332,517	$ 68,450	$ 2,157,177
Loans					
Ending balance individually evaluated for impairment	$ 369,112	$ 761,330	$ 29,453	$ 434,087	$ 1,593,982
Ending balance collectively evaluated for impairment	$ 24,839,968	$ 73,585,292	$ 12,747,852	$ 32,199,333	$ 143,372,445
Total loans	$ 25,209,080	$ 74,346,622	$ 12,777,305	$ 32,633,420	$ 144,966,427

Credit quality indicators

The Bank's risk rating methodology assigns risk ratings ranging from 1 to 9, where a higher rating represents higher risk. The Bank differentiates its lending portfolios into homogeneous loans (generally consumer loans) and non-homogeneous loans (generally all non-consumer loans). The 9 risk rating categories can be generally described by the following groupings for non-homogeneous loans:

Low Risk – These loans range from minimal credit risk to modest credit risk. These loans may be secured by cash, certificates of deposit, or investments. Borrowers are individuals and companies with well-established reputations and operating in reasonably stable industries. Cash flow from recurring sources is expected to continue to produce adequate debt service capacity.

Average Risk – These loans range from better than average to average credit risk. Primary repayment sources generate satisfactory debt service coverage under normal conditions. Cash flow from recurring sources is expected to continue to produce adequate debt service capacity. Borrowers have the ability to endure business cycles and usually have access to additional credit sources.

Acceptable Risk – Loans are graded as acceptable when there are some management weaknesses present or weakness of underlying fundamentals. This includes loans that have limited debt capacity, modest debt service coverage and below average asset quality, margins, or market share. These borrowers may be performing, but sensitive to market trends or business cycles.

Note 4 – Allowance for Loan Losses (continued)

Watch – A watch rating indicates that, according to current information, the borrower has the capacity to perform according to terms; however, elements of uncertainty exist (an uncharacteristic negative financial or other risk factor event). Margins of debt service coverage are narrow, and historical patterns of financial performance may be erratic, although overall trends are positive. Often the operating assets of the company and/or real estate will secure these loans. If secured, collateral value and adequate sources of repayment currently protect the loan. Material adverse trends have not developed at this time. Loans in this category can be new and/or thinly capitalized companies.

Special Mention – A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or the Bank's credit position at some future date. They contain unfavorable characteristics and are generally undesirable. Loans in this category are currently protected but are potentially weak and constitute an undue and unwarranted credit risk, but not to the point of a Substandard classification. A Special Mention loan has potential weaknesses, which if not checked or corrected, weaken the asset or inadequately protect the Bank's position at some future date. Unlike a Substandard credit, there is a reasonable expectation that these temporary issues will be corrected within the normal course of business, rather than a liquidation of assets, and in a reasonable period of time.

Substandard – A Substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified have a well-defined weakness or weaknesses that jeopardize the orderly repayment of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not necessarily exist in each individual asset classified as Substandard. The likely need to liquidate assets to correct the problem, rather than repayment from successful operations, is the key distinction between Special Mention and Substandard loans.

Doubtful – Loans classified as Doubtful have all the weaknesses inherent in one classified as Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work towards strengthening of the asset, classification as a Loss (and immediate charge-off) is deferred until more exact status may be determined.

Loss – These loans are considered uncollectible and of such little value that their continuance as active assets of the Bank is not warranted. This classification does not mean that the loan has no recovery or salvage value, but rather that it is not practical or desirable to defer writing it off as an asset. While Loss is an active grade in the risk rating system, any loan considered to be in this category is to be charged-off as soon as possible.

Note 4 – Allowance for Loan Losses (continued)

The following tables show credit quality indicators as of December 31:

	2017				
	Commercial	Commercial Real Estate	Consumer	Residential	Total
Low Risk	$ 5,368,870	$ 2,609,876	$ 6,587,653	$ 9,684,485	$ 24,250,884
Average Risk	2,583,047	27,380,825	5,433,810	7,520,897	42,918,579
Acceptable Risk	27,074,640	34,557,500	7,780,409	15,122,216	84,534,765
Watch	1,828,242	2,177,569	7,154	974,714	4,987,679
Special Mention	655,716	4,635,257	1,224	339,861	5,632,058
Substandard	40,000	457,416	23,519	492,387	1,013,322
Doubtful	-	-	-	-	-
Total	$ 37,550,515	$ 71,818,443	$ 19,833,769	$ 34,134,560	$ 163,337,287

	2016				
	Commercial	Commercial Real Estate	Consumer	Residential	Total
Low Risk	$ 4,504,721	$ 2,145,344	$ 2,426,174	$ 10,762,790	$ 19,839,029
Average Risk	3,399,678	32,104,401	9,129,790	8,387,340	53,021,209
Acceptable Risk	15,504,841	33,906,715	937,118	11,844,352	62,193,026
Watch	1,528,494	3,337,707	249,217	1,082,387	6,197,805
Special Mention	-	1,716,261	20,377	403,917	2,140,555
Substandard	271,346	1,136,194	14,629	152,634	1,574,803
Doubtful	-	-	-	-	-
Total	$ 25,209,080	$ 74,346,622	$ 12,777,305	$ 32,633,420	$ 144,966,427

Note 4 – Allowance for Loan Losses (continued)

The following table shows the age analysis of past due and nonaccrual loans as of December 31, 2017 and 2016:

	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or Greater	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days Past Due and Accruing	Nonaccrual Loans
December 31, 2017								
Commercial	$ 118,109	$ -	$ 40,000	$ 158,109	$ 37,392,406	$ 37,550,515	$ -	$ 125,856
Commercial real estate	-	80,033	131,314	211,347	71,607,096	71,818,443	-	193,437
Consumer	139,325	75,079	43,165	257,569	19,576,200	19,833,769	-	21,677
Residential	792,630	31,500	335,150	1,159,280	32,975,280	34,134,560	-	624,950
	$ 1,050,064	$ 186,612	$ 549,629	$ 1,786,305	$ 161,550,982	$ 163,337,287	$ -	$ 965,920

	30 – 59 Days Past Due	60 – 89 Days Past Due	90 Days or Greater	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days Past Due and Accruing	Nonaccrual Loans
December 31, 2016								
Commercial	$ -	$ -	$ 271,346	$ 271,346	$ 24,937,734	$ 25,209,080	$ -	$ 369,112
Commercial real estate	-	-	-	-	74,346,622	74,346,622	-	225,155
Consumer	9,030	13,313	152,526	174,869	12,602,436	12,777,305	-	8,444
Residential	123,025	50,219	52,055	225,299	32,408,121	32,633,420	-	319,600
	$ 132,055	$ 63,532	$ 475,927	$ 671,514	$ 144,294,913	$ 144,966,427	$ -	$ 922,311

Note 4 – Allowance for Loan Losses (continued)

The following table discloses information related to impaired loans for the years ended December 31, 2017 and 2016:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
December 31, 2017				
With no related allowance recorded				
Commercial	$ 85,856	$ 85,856	$ -	$ 91,811
Commercial real estate	193,437	193,437	-	210,462
Residential	380,662	380,662	-	406,516
Consumer	9,418	9,418	-	15,296
	669,373	669,373	-	724,085
With an allowance recorded				
Commercial	40,000	40,000	25,000	155,673
Commercial real estate	401,448	401,448	13,675	467,646
Residential	444,736	444,736	105,471	455,878
Consumer	24,525	24,525	3,256	26,274
	910,709	910,709	147,402	1,105,471
Totals				
Commercial	125,856	125,856	25,000	247,484
Commercial real estate	594,885	594,885	13,675	678,108
Residential	825,398	825,398	105,471	862,394
Consumer	33,943	33,943	3,256	41,570
	$ 1,580,082	$ 1,580,082	$ 147,402	$ 1,829,556
December 31, 2016				
With no related allowance recorded				
Commercial real estate	$ 72,629	$ 72,629	$ -	$ 847,360
Residential	166,246	166,246	-	185,146
Consumer	8,444	8,444	-	11,250
	247,319	247,319	-	1,043,756
With an allowance recorded				
Commercial	369,112	369,112	272,057	469,623
Commercial real estate	688,701	688,701	22,779	763,301
Residential	267,841	267,841	19,912	271,164
Consumer	21,009	21,009	1,653	15,596
	1,346,663	1,346,663	316,401	1,519,684
Totals				
Commercial	369,112	369,112	272,057	469,623
Commercial real estate	761,330	761,330	22,779	1,610,661
Residential	434,087	434,087	19,912	456,310
Consumer	29,453	29,453	1,653	26,846
	$ 1,593,982	$ 1,593,982	$ 316,401	$ 2,563,440

Note 4 – Allowance for Loan Losses (continued)

Interest recognized on impaired loans during the years ended December 31, 2017 and 2016 was immaterial.

The Bank offers a variety of modifications to borrowers under circumstances of troubled debt restructurings. The modification categories offered can generally be described in the following categories:

Rate modification – A modification in which the interest rate is changed.

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

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

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

Combination modification – Any other type of modification, including the use of multiple categories above.

The following tables present troubled debt restructurings by interest accrual status as of December 31, 2017 and 2016:

	December 31, 2017		
	Accrual Status	Non-Accrual Status	Total Modifications
Commercial real estate	$ 401,448	$ -	$ 401,448
Residential	113,183	142,281	255,464
Commercial	-	85,856	85,856
Consumer	12,266	-	12,266
	$ 526,897	$ 228,137	$ 755,034

	December 31, 2016		
	Accrual Status	Non-Accrual Status	Total Modifications
Commercial real estate	$ 536,175	$ -	$ 536,175
Residential	114,487	153,354	267,841
Commercial	-	97,767	97,767
Consumer	14,629	-	14,629
	$ 665,291	$ 251,121	$ 916,412

Note 4 – Allowance for Loan Losses (continued)

As of December 31, 2017 and 2016, no lending commitments were outstanding for troubled debt restructurings.

During 2017, there were no loans modified as troubled debt restructurings. During 2016, there was one residential loan and one commercial loan in the amounts of $153,354 and $97,767, respectively, modified as troubled debt restructurings. Both were combination modifications as of December 31, 2016.

During 2017 and 2016, there were no troubled debt restructurings with a payment default occurring within 12 months of the restructure date.

Note 5 – Premises, Equipment, and Leasehold Improvements

The composition of premises, equipment, and leasehold improvements at December 31 are summarized as follows:

	2017	2016
Buildings and leasehold improvements	$ 9,012,289	$ 8,934,565
Equipment	6,252,264	6,062,911
Land	708,307	708,307
Construction in progress	-	49,734
	15,972,860	15,755,517
Less accumulated depreciation and amortization	(10,899,749)	(10,401,399)
Premises, equipment, and leasehold improvements, net of accumulated depreciation and amortization	$ 5,073,111	$ 5,354,118

Depreciation and amortization expense totaled $498,350 and $573,381 for 2017 and 2016, respectively.

Note 6 – Time Deposits

Time certificates of deposit of $250,000 and over totaled $9,589,511 and $8,635,526 at December 31, 2017 and 2016, respectively.

As of December 31, 2017, the scheduled maturities for all time deposits were as follows:

Years ending December 31,	2018	$ 26,847,295
	2019	3,688,998
	2020	1,668,359
	2021	416,136
	2022	1,003,243
		$ 33,624,031

Note 7 – Borrowings

Federal Home Loan Bank advances

As a member of the FHLB, the Bank has entered into a “Cash Management Advance Promissory Note” Program with the FHLB. Borrowings under the credit arrangement are collateralized by the Bank’s FHLB stock as well as deposits, investment securities or other instruments, which may be pledged. At December 31, 2017, the Bank had borrowings under this agreement of $500,000, which matures in 2018 and bearing interest at a rate of 1.63%. No balances were outstanding as of December 31, 2016.

Federal funds lines of credit and other borrowing arrangements

The Bank has obtained federal funds lines of credit totaling $16,500,000 with three correspondent banks. These lines of credit will expire upon consent of both parties. The Bank also has a borrowing line of $500,000 with the Federal Reserve Bank of San Francisco collateralized by investment securities. There were no balances outstanding on these federal funds lines of credit and the Federal Reserve borrowing line as of December 31, 2017 and 2016.

Note 8 – Income Taxes

The provision for income taxes consists of the following for the years ended December 31:

	2017	2016
Current tax expense		
Federal	$ 226,625	$ 586,676
State	33,479	93,517
	260,104	680,193
Deferred tax benefit		
Federal	(52,575)	(258,814)
State	(9,645)	(47,488)
	(62,220)	(306,302)
Provision for income taxes	$ 197,884	$ 373,891

Note 8 – Income Taxes (continued)

The following table presents the reconciliation of the federal statutory rate to the actual effective rate for the years ended December 31:

	2017		2016	
Statutory Federal income tax rate	$ 748,746	34.0%	$ 918,840	34.0%
State tax, net of Federal benefit	136,624	6.2%	167,661	6.2%
Tax exempt interest and non-taxable income	(673,983)	-30.6%	(671,771)	-24.9%
Tax reform rate change adjustment	11,732	0.5%	-	0.0%
Other, net	(25,235)	-1.1%	(40,839)	-1.5%
Provision for income taxes	$ 197,884	9.0%	$ 373,891	13.8%

Deferred income taxes, recorded as other assets at December 31, 2017 and 2016, represent the tax effect of differences in timing between financial statement income and taxable income. The net deferred tax assets and liabilities, in the accompanying consolidated balance sheets at December 31, include the following components:

	2017	2016
Deferred tax assets		
Excess of provision for loan losses over deduction	$ 596,290	$ 794,033
Deferred compensation	170,843	143,950
Accrued leave	62,113	79,569
Nonaccrual interest income	29,143	46,248
Tax credits	129,000	-
Other reserves	5,132	37,153
OREO Writedown	6,278	-
Total deferred tax assets	998,799	1,100,953
Deferred tax liabilities		
Accelerated depreciation	(153,160)	(293,407)
Prepaids	(82,939)	-
Deferred loan costs	(67,781)	-
Unrealized gain on securities available-for-sale	(421,991)	(512,868)
Total deferred tax liabilities	(725,871)	(806,275)
Net deferred tax assets	$ 272,928	$ 294,678

Management believes, based upon the Company's historical performance, the deferred tax assets will be realized in the normal course of operations and, accordingly, management has not reduced net deferred tax assets by a valuation allowance.

Note 8 – Income Taxes (continued)

The Bank recognized an adjustment to the net deferred tax asset in December 2017 as a tax expense upon enactment of the new Federal tax law. Deferred tax assets and liabilities in the table below reflect the new measurement.

The Company's tax expense varies from statutory rates primarily due to non-taxable income. During the years ended December 31, 2017 and 2016, the Company recognized no interest and penalties related to income taxes. As of December 31, 2017 and 2016, the Company had no unrecognized tax benefits. Management does not anticipate the amount of unrecognized tax benefits will significantly change in the next 12 months.

Note 9 – Commitments and Contingencies

Lease arrangements
The Company leases several branch facilities under operating lease agreements that will expire between 2018 and 2024. In addition, the Company leases office space to two tenants, also under operating lease agreements.

Future minimum lease payments and receipts associated with lease agreements are as follows:

		Payments as Lessee	Receipts as Lessor
Years ending December 31,	2018	$ 162,088	$ 179,520
	2019	111,680	84,400
	2020	119,040	-
	2021	119,040	-
	2022	119,040	-
	Thereafter	218,240	-
		$ 849,128	$ 263,920

Rent expense was $183,504 for the years ended December 31, 2017 and 2016. Rental income was $179,520 for the years ended December 31, 2017 and 2016. Both rental income and expense are recorded within net occupancy expenses.

Legal contingencies
The Company may become a defendant in certain claims and legal actions arising in the ordinary course of business. There can be no assurance that the ultimate outcome will not differ materially from the Company's assessment of each matter. There can also be no assurance that all matters that may be brought against the Company are known to management or the Board of Directors at any point in time. In the opinion of management, after consultation with counsel regarding outstanding legal matters that could possibly result in a financial loss, there are no matters presently known to the Company that are expected to have a material adverse effect on the Company's financial condition or results of operations.

Note 9 – Commitments and Contingencies (continued)

Off-balance sheet credit risk
In the normal course of business to meet the financing needs of its customers, the Bank is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit and the issuance of letters of credit. These instruments involve, to varying degrees, elements of credit and interest-rate risk in excess of the amounts recognized in the balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

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

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

Letters of credit written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds cash, marketable securities, or real estate as collateral supporting those commitments for which collateral is deemed necessary.

At December 31, 2017, the Bank had outstanding commitments for letters of credit, unused lines of credit and origination of loans that are not reflected in the accompanying consolidated financial statements as follows:

Lines of credit	$ 10,472,000
Commitments to extend credit	3,840,000
Home equity lines	4,398,000
Other unused commitments	1,384,000
Letters of credit	150,000
Total commitments	$ 20,244,000

Note 10 – Concentrations of Credit Risk

Substantially all of the Bank's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area. The majority of such customers are also depositors of the Bank. Concentrations of credit by type of loan are set forth in Note 3. The Bank's loan policy does not allow the extension of credit to any single borrower or group of related borrowers in excess of $500,000 without approval from the Board of Directors' Loan Committee.

Note 11 – Transactions with Related Parties

Certain directors, executive officers, and principal stockholders are customers of and have had banking transactions with the Bank in the ordinary course of business, and the Bank expects to have such transactions in the future. All loans and commitments to lend included in such transactions are made in compliance with applicable laws on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons and, in the opinion of the management of the Bank, do not involve more than the normal risk of collection or present any other unfavorable features. The amount of loans and loan commitments outstanding to directors, executive officers, principal stockholders, and companies that they are associated with at December 31 was as follows:

	2017	2016
Balance, beginning of year	$ 3,637,945	$ 4,123,987
Loans made	4,122,269	2,965,822
Loans repaid	(4,675,240)	(3,451,864)
Balance, end of year	$ 3,084,974	$ 3,637,945

As of December 31, 2017 and 2016, funds on deposit with the Bank from directors, principal stockholders, their related interests, and principal officers totaled $8,799,064 and $8,906,888, respectively.

The Company's directors are issued stock as compensation for attending meetings. The stock is valued at the average sales price for all stock transactions that occurred during the 12-month period preceding the issuance.

During the year ended December 31, 2017, the Company issued directors 6,900 shares at $9.25 a share as compensation for attending meetings.

Note 12 – Employee Benefit Plans

401(k) pension and profit sharing plans

The Company has a 401(k) defined contribution profit sharing plan that covers all eligible employees. Participants may elect to contribute to the 401(k) plan up to the limits set by the Internal Revenue Code. To encourage employee participation in saving for retirement, the Company contributes a 3% non-elective safe harbor election, and also elected a 2% Company match for all eligible employees contributing to the 401(k) plan. The Company contributed $235,800 and $230,921 to this plan in 2017 and 2016, respectively. The Company may also make annual profit sharing contributions, as determined by the Board of Directors, but may not exceed the percentage of compensation allowable for income tax purposes. Company profit sharing contributions to the 401(k) plan were $164,000 and $184,000 for the years ended December 31, 2017 and 2016, respectively.

Supplemental executive retirement and deferred compensation plans

A supplemental executive retirement plan was established in 1996 to cover certain executive employees. The Company may make contributions to the plan at the discretion of the Board of Directors. However, the Company made no contributions to the plan during either 2017 or 2016. The total recorded plan obligation was $95,006 and $101,816 for years ended December 31, 2017 and 2016, respectively. Contributions are held in a trust account for the benefit of the participants, with an offsetting liability account maintained to recognize the Company's obligation under the plan.

A separate supplemental executive retirement plan was established in 2016 to benefit certain executives and senior management. Participants are vested 100% after five years of service. Upon reaching retirement age, as determined by the plan, participants receive a monthly benefit upon retirement age paid out over a period of 15 years. As of December 31, 2017 and 2016, the liability associated with this plan was $496,625 and $243,353, respectively, and the Company recorded expense in the statement of income for the years ended December 31, 2017 and 2016 of $253,272 and $243,353, respectively. The Bank holds bank-owned life insurance on the participants to fund the supplemental retirement obligations under this plan.

Note 13 – Fair Values of Assets and Liabilities

The following table presents information about the Bank's assets measured at fair value on a recurring and nonrecurring basis, and indicates the fair value hierarchy of the valuation techniques utilized by the Bank to determine such fair value:

	Fair Value Measurements			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2017:				
Recurring items:				
Mortgage-backed securities	$ 34,023,058	$ -	$ 34,023,058	$ -
Obligations of states and political subdivisions	33,531,827	-	33,531,827	-
Obligations of U.S. government corporations and agencies	3,492,419	-	3,492,419	-
	$ 71,047,304	$ -	$ 71,047,304	$ -
Nonrecurring items:				
Impaired loans, net	$ 763,307	$ -	$ -	$ 763,307
Other real estate owned	1,810,350	-	-	1,810,350
	$ 2,573,657	$ -	$ -	$ 2,573,657
December 31, 2016:				
Recurring items:				
Mortgage-backed securities	$ 39,637,382	$ -	$ 39,637,382	$ -
Obligations of states and political subdivisions	33,837,843	-	33,837,843	-
Obligations of U.S. government corporations and agencies	7,078,774	-	7,078,774	-
Corporate securities	2,016,562	2,016,562	-	-
	$ 82,570,561	$ 2,016,562	$ 80,553,999	$ -
Nonrecurring items:				
Impaired loans, net	$ 1,030,262	$ -	$ -	$ 1,030,262
Other real estate owned	1,995,507	-	-	1,995,507
	$ 3,025,769	$ -	$ -	$ 3,025,769

Note 13 – Fair Values of Assets and Liabilities (continued)

Assets and liabilities are reported in the table by recurring or nonrecurring measurement status. Recurring assets are initially measured at fair value and are required to be remeasured at fair value in the consolidated financial statements at each reporting date. Assets measured on a nonrecurring basis are assets that, due to an event or circumstance, were required to be remeasured at fair value after initial recognition in the consolidated financial statements at some time during the reporting period.

The following table provides a description of the valuation technique, observable input and qualitative information about the unobservable inputs for the Company's assets classified as Level 3 and measured at fair value on a recurring and nonrecurring basis at December 31, 2017 and 2016:

			Discount Range	
Financial Instruments	Valuation Technique	Unobservable Inputs	2017	2016
Other real estate owned	Market comparable	Adjustments to appraised values	11%	10% - 16%
Impaired loans, net	Market comparable	Adjustments to appraised values	10% - 16%	10% - 16%

Note 14 – Regulatory Capital

The Company and 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 the Company and Bank's financial statements. Under capital adequacy guidelines, the Company and Bank must meet specific capital adequacy guidelines that involve quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company and Bank's capital classifications 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 the Company and Bank to maintain minimum amounts and ratios (set forth in the following table) of Tier 1 capital (as defined in the regulations) to total average assets (as defined), and minimum ratios of Tier 1, common equity Tier 1 and total capital (as defined) to risk-weighted assets (as defined). Management believes, as of December 31, 2017 and 2016, that the Company and Bank meet all capital requirements to which it is subject.

As of the most recent notifications from its regulatory agencies, the Bank was categorized as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based capital, Tier 1 risk-based capital, common equity Tier 1 and Tier 1 leverage capital ratios as set forth in the following table. There are no conditions or events since that notification that management believes may have changed the Bank's category.

Note 14 – Regulatory Capital (continued)

The capital ratios for the Company are substantially the same as those of the Bank.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount ($000s)	Ratio	Amount ($000s)	Ratio	Amount ($000s)	Ratio
December 31, 2017						
Total risk-based capital (to risk-weighted assets)	$ 28,858	15.9%	$ 14,510	8.0%	$ 18,137	10.0%
Tier I capital (to risk-weighted assets)	$ 26,589	14.7%	$ 10,882	6.0%	$ 14,510	8.0%
Common equity tier 1 (to risk-weighted assets)	$ 26,589	14.7%	$ 8,162	4.5%	$ 11,789	6.5%
Tier I capital (to average total assets)	$ 26,589	9.7%	$ 10,927	4.0%	$ 13,659	5.0%
December 31, 2016						
Total risk-based capital (to risk-weighted assets)	$ 28,517	17.1%	$ 13,351	8.0%	$ 16,689	10.0%
Tier I capital (to risk-weighted assets)	$ 26,426	15.8%	$ 10,013	6.0%	$ 13,351	8.0%
Common equity tier 1 (to risk-weighted assets)	$ 26,426	15.8%	$ 7,510	4.5%	$ 10,848	6.5%
Tier I capital (to average total assets)	$ 26,426	9.7%	$ 10,899	4.0%	$ 13,623	5.0%

The Bank is required to establish and phase-in a “conservation buffer,” consisting of a common equity Tier 1 capital amount equal to 2.5% of risk-weighted assets by 2019. As of December 31, 2017, the “conservation buffer” amount was 1.25% of risk-weighted assets. An institution that does not meet the conservation buffer requirement will be subject to restrictions on certain activities including payment of dividends, stock repurchases, and discretionary bonuses to executive officers. The phase-in began in 2016 and increases until fully phased-in by 2019.

Dividends

Regulations of the FDIC do not permit the Bank to pay dividends on its common stock if stockholders’ equity would thereby be reduced below the Bank’s regulatory capital requirements.

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