

**UNITED BANCORPORATION
OF ALABAMA, INC.
AND SUBSIDIARY**

CONSOLIDATED FINANCIAL REPORT

DECEMBER 31, 2013

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARY**

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INDEPENDENT AUDITOR'S REPORT

**To the Board of Directors
United Bancorporation of Alabama, Inc.
Atmore, Alabama**

We have audited the accompanying consolidated financial statements of **United Bancorporation of Alabama, Inc. and Subsidiary**, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of earnings, comprehensive income (loss), 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 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 of 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 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 United Bancorporation of Alabama, Inc. and Subsidiary as of December 31, 2013 and 2012, 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.

A handwritten signature in black ink that reads "Mauldin & Jenkins, LLC". The signature is written in a cursive, flowing style.

Birmingham, Alabama
March 25, 2014

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARY**

**CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2013 AND 2012**

<u>Assets</u>	<u>2013</u>	<u>2012</u>
Cash and due from banks	\$ 19,311,185	\$ 18,911,407
Interest-bearing deposits in banks	44,182,014	52,387,807
Federal funds sold	12,000,000	-
Cash and short-term investments	<u>75,493,199</u>	<u>71,299,214</u>
Securities available for sale, at fair value (amortized cost of \$120,255,458 and \$95,953,049 at December 31, 2013 and 2012, respectively)	117,960,790	97,251,331
Loans held for sale	883,375	206,625
Loans held for investment	252,337,059	264,620,015
Less allowance for loan losses	3,791,698	4,500,693
Loans, net	<u>248,545,361</u>	<u>260,119,322</u>
Premises and equipment, net	15,210,789	15,579,291
Interest receivable	1,857,754	2,060,649
Bank owned life insurance	8,255,367	3,057,126
Other real estate owned	9,698,489	8,198,175
Other assets	9,003,808	9,392,517
Total assets	<u><u>\$ 486,908,932</u></u>	<u><u>\$ 467,164,250</u></u>
<u>Liabilities and Stockholders' Equity</u>		
Deposits		
Noninterest-bearing	\$ 158,022,852	\$ 144,790,062
Interest-bearing	277,876,354	270,609,984
Total deposits	<u>435,899,206</u>	<u>415,400,046</u>
Advances from Federal Home Loan Bank of Atlanta	803,499	956,566
Interest payable	162,521	200,225
Accrued expenses and other liabilities	1,890,486	1,657,948
Note payable to Trust	10,310,000	10,310,000
Total liabilities	<u>449,065,712</u>	<u>428,524,785</u>
Commitments (Note 18)		
Stockholders' equity		
Preferred stock, par value \$.01. Authorized 250,000 shares; 10,300 shares issued in 2013 and 2012, respectively	10,300,000	10,222,501
Class A common stock, par value \$0.01. Authorized 5,000,000 shares; issued and outstanding, 2,390,822 and 2,388,676 shares in 2013 and 2012, respectively	23,908	23,887
Class B common stock, par value \$0.01. Authorized 250,000 shares; no shares issued or outstanding	-	-
Additional paid-in capital	7,194,122	7,170,327
Retained earnings	21,727,965	20,511,650
Accumulated other comprehensive income (loss), net of tax	(1,399,192)	714,683
	<u>37,846,803</u>	<u>38,643,048</u>
Less 439 treasury shares, at cost	3,583	3,583
Total stockholders' equity	<u>37,843,220</u>	<u>38,639,465</u>
Total liabilities and stockholders' equity	<u><u>\$ 486,908,932</u></u>	<u><u>\$ 467,164,250</u></u>

See accompanying notes to consolidated financial statements

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF EARNINGS
YEARS ENDED DECEMBER 31, 2013 AND 2012**

	2013	2012
Interest income		
Interest and fees on loans	\$ 14,706,758	\$ 16,016,853
Interest on investment securities:		
Taxable securities	1,294,420	1,043,751
Nontaxable securities	186,589	224,901
Total investment income	1,481,009	1,268,652
Other interest income	150,745	126,085
Total interest income	16,338,512	17,411,590
Interest expense		
Interest on deposits	1,614,645	2,250,937
Interest on other borrowed funds	285,415	308,861
Total interest expense	1,900,060	2,559,798
Net interest income	14,438,452	14,851,792
Provision for loan losses	497,500	2,205,000
Net interest income after provision for loan losses	13,940,952	12,646,792
Noninterest income:		
Service charges on deposits	3,035,690	3,073,402
Investment securities gains, net	390,026	941,572
Mortgage loan and related fees	452,832	411,584
Other	1,526,585	1,332,150
Total noninterest income	5,405,133	5,758,708
Noninterest expense:		
Salaries and benefits	9,057,124	8,933,691
Net occupancy expense	1,908,142	1,930,120
Other	5,808,616	6,019,002
Total noninterest expense	16,773,882	16,882,813
Net earnings before income tax expense	2,572,203	1,522,687
Income tax expense	809,554	347,466
Net earnings	1,762,649	1,175,221
Preferred stock dividends	206,000	206,000
Accretion on preferred stock discount	77,499	73,178
Net earnings available to common shareholders	\$ 1,479,150	\$ 896,043
Basic earnings per share	\$ 0.62	\$ 0.38
Basic weighted-average shares outstanding	2,390,313	2,375,302
Diluted earnings per share	\$ 0.62	\$ 0.38
Diluted weighted-average shares outstanding	2,390,313	2,375,302

See accompanying notes to consolidated financial statements

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
YEARS ENDED DECEMBER 31, 2013 AND 2012**

	<u>2013</u>	<u>2012</u>
Net earnings	<u>\$ 1,762,649</u>	<u>\$ 1,175,221</u>
Other comprehensive income (loss)		
Unrealized holding gains (losses) on securities available for sale arising during the period, net of tax expense (benefit) of \$(1,281,169) and \$679,193, respectively	(1,921,757)	1,018,786
Reclassification adjustment for gains on securities available for sale realized in net earnings from sales, net of taxes of \$156,010 and \$376,629, respectively	(234,016)	(564,943)
Unrealized gains (losses) on cash flow hedges arising during period, net of tax expense (benefit) of \$27,932 and \$(42,853), respectively	<u>41,898</u>	<u>(64,279)</u>
Total other comprehensive income (loss)	<u>(2,113,875)</u>	<u>389,564</u>
Comprehensive income (loss)	<u><u>\$ (351,226)</u></u>	<u><u>\$ 1,564,785</u></u>

See accompanying notes to consolidated financial statements

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2013 AND 2012**

	<u>Preferred Stock</u>	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Treasury Stock</u>	<u>Total</u>
		<u>Shares</u>	<u>Par Value</u>					
Balance, December 31, 2011	\$ 10,149,323	2,389,127	\$ 23,891	\$ 7,114,042	\$ 19,984,862	\$ 325,119	\$ (328,214)	\$ 37,269,023
Net earnings	-	-	-	-	1,175,221	-	-	1,175,221
Other comprehensive income	-	-	-	-	-	389,564	-	389,564
Treasury shares issued as stock dividend	-	-	-	39,899	(364,530)	-	324,631	-
Cash portion of stock dividend (fractional shares)	-	-	-	-	(4,725)	-	-	(4,725)
Cancellation of restricted stock grants	-	(451)	(4)	(7,613)	-	-	-	(7,617)
Stock-based compensation	-	-	-	23,999	-	-	-	23,999
Accretion on preferred stock discount	73,178	-	-	-	(73,178)	-	-	-
Preferred stock dividends paid	-	-	-	-	(206,000)	-	-	(206,000)
Balance, December 31, 2012	<u>10,222,501</u>	<u>2,388,676</u>	<u>23,887</u>	<u>7,170,327</u>	<u>20,511,650</u>	<u>714,683</u>	<u>(3,583)</u>	<u>38,639,465</u>
Net earnings	-	-	-	-	1,762,649	-	-	1,762,649
Other comprehensive loss	-	-	-	-	-	(2,113,875)	-	(2,113,875)
Cash dividend declared (\$.11 per share)	-	-	-	-	(262,835)	-	-	(262,835)
Shares issued in accordance with dividend reinvestment plan	-	2,319	23	20,847	-	-	-	20,870
Cancellation of restricted stock grants	-	(173)	(2)	(2,827)	-	-	-	(2,829)
Stock-based compensation	-	-	-	5,775	-	-	-	5,775
Accretion on preferred stock discount	77,499	-	-	-	(77,499)	-	-	-
Preferred stock dividends paid	-	-	-	-	(206,000)	-	-	(206,000)
Balance, December 31, 2013	<u>\$ 10,300,000</u>	<u>2,390,822</u>	<u>\$ 23,908</u>	<u>\$ 7,194,122</u>	<u>\$ 21,727,965</u>	<u>\$ (1,399,192)</u>	<u>(3,583)</u>	<u>\$ 37,843,220</u>

See accompanying notes to consolidated financial statements

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARY**

**CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2013 AND 2012**

	2013	2012
OPERATING ACTIVITIES		
Net earnings	\$ 1,762,649	\$ 1,175,221
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for loan losses	497,500	2,205,000
Depreciation of premises and equipment	885,394	883,111
Net amortization of premium on investment securities available for sale	903,133	745,098
Gain on sales of investment securities available for sale, net	(390,026)	(941,572)
Gain on sales of other real estate owned	(81,788)	(56,260)
Gain on sales of loans held for sale	(388,300)	(310,984)
Originations of loans held for sale	(16,524,801)	(12,670,249)
Proceeds from sales of loans held for sale	16,236,351	12,944,008
Earnings on bank owned life insurance	(198,241)	(102,693)
Stock-based compensation	5,775	23,999
Provision for deferred income taxes	510,868	269,544
Provision for other real estate owned losses	775,918	1,317,000
Decrease in interest receivable	202,895	94,848
(Increase) decrease in other assets	929,894	(1,725,186)
Decrease in Federal Deposit Insurance Corporation prepaid deposit assessment	424,193	382,090
Decrease in interest payable	(37,704)	(87,461)
Increase in accrued expenses and other liabilities	89,115	294,134
	<u>5,602,825</u>	<u>4,439,648</u>
INVESTING ACTIVITIES		
Proceeds from maturities, calls, and principal repayments of investment securities available for sale	13,750,883	19,986,348
Proceeds from maturities, calls, and principal repayments of investment securities held to maturity	-	1,244,668
Proceeds from sales of investment securities available for sale	15,667,027	16,647,543
Purchases of investment securities available for sale	(54,233,426)	(41,634,199)
Net decrease (increase) in loans	7,954,933	(5,599,329)
Purchases of premises and equipment, net	(516,892)	(608,769)
Purchase of bank owned life insurance	(5,000,000)	-
Proceeds from sale of other real estate owned	927,084	1,964,419
	<u>(21,450,391)</u>	<u>(7,999,319)</u>
FINANCING ACTIVITIES		
Net increase in deposits	20,499,160	19,946,108
Cash dividends paid - preferred stock	(206,000)	(206,000)
Cash dividends paid - common stock	(119,412)	(4,725)
Proceeds from sale of common stock through dividend reinvestment plan	20,870	-
Repayments of advances from FHLB Atlanta	(153,067)	(158,934)
Decrease in other borrowed funds	-	(991,750)
	<u>20,041,551</u>	<u>18,584,699</u>
Net increase in cash and short-term investments	4,193,985	15,025,028
Cash and short-term investments at beginning of year	71,299,214	56,274,186
Cash and short-term investments at end of year	<u>\$ 75,493,199</u>	<u>\$ 71,299,214</u>
SUPPLEMENTAL DISCLOSURE		
Cash paid during the year for:		
Interest	\$ 1,937,764	\$ 2,647,259
Income taxes	\$ 418,600	\$ 345,644
OTHER NONCASH TRANSACTIONS		
Transfer of loans to other real estate through foreclosure	\$ 4,888,904	\$ 1,715,772
Internally financed sales of other real estate owned	\$ 1,767,376	\$ 238,545
Transfer of securities from held to maturity to available for sale	\$ -	\$ 19,804,309

See accompanying notes to consolidated financial statement,

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

United Bancorporation of Alabama, Inc. (the “Corporation”) is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, United Bank (the “Bank”). United Bank is a commercial bank with headquarters in Atmore, Alabama. The Bank provides a full range of banking services in its primary market areas of Baldwin, Escambia, and Monroe Counties, Alabama, and Santa Rosa County, Florida.

Principles of Consolidation

The accompanying consolidated financial statements include the financial statements of United Bancorporation of Alabama, Inc. and United Bank, collectively referred to as the Corporation. Significant inter-company balances and transactions have been eliminated in consolidation.

Market Concentrations

The Corporation operates primarily in one business segment, commercial banking, in Southwest Alabama and Northwest Florida.

Basis of Presentation and Accounting Estimates

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the period. Actual results could differ significantly from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, other real estate owned, deferred taxes, the valuation of other than temporary impairment for investment securities, and the fair value of financial instruments.

The Corporation has evaluated all transactions, events, and circumstances for consideration or disclosure through March 25, 2014, the date these financial statements were available to be issued and has reflected or disclosed those items within the consolidated financial statements and related footnotes as deemed appropriate.

Reclassification

Certain amounts in the 2012 consolidated financial statements have been reclassified to conform to the 2013 presentation.

Fair Valuation of Financial Instruments

Fair values of financial instruments are estimates using relevant market information and other assumptions, as more fully disclosed in Note 15. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Short-Term Investments

The Corporation considers cash and due from banks, interest-bearing deposits in banks, and federal funds sold to be cash and short-term investments. Federal funds are generally sold for one-day periods.

Investment Securities

Investment securities are classified in one of three portfolios: (i) trading account securities, (ii) securities available for sale, or (iii) securities held to maturity. Trading account securities are stated at fair value. Investment securities available for sale are stated at fair value with any unrealized gains and losses reported in a separate component of stockholders' equity, net of tax effect, until realized. Once realized, gains and losses on investment securities available for sale are reflected in current period earnings. Investment securities held to maturity are stated at cost adjusted for amortization of premiums and accretion of discounts. As of December 31, 2013, the Corporation classified all securities available for sale and no securities were classified as securities held to maturity.

Net gains and losses on the sale of investment securities available for sale are recorded at trade date. The net gains and losses are computed using the specific identification method and are shown separately in noninterest income in the consolidated statements of earnings. Accretion of discounts and amortization of premiums are calculated on the effective interest method over the anticipated life of the security.

A decline in the fair value of any security below amortized cost that is deemed other than temporary is charged to earnings resulting in the establishment of a new cost basis for the security.

Restricted Equity Securities

The Corporation is required to maintain an investment in capital stock of various entities. Based on redemption provisions of these entities, the stock has no quoted market value and is carried at cost. At their discretion, these entities may declare dividends on the stock. Management reviews for impairment based on the ultimate recoverability of the cost basis in these stocks.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balances less the allowance for loan losses. Interest income is accrued on the outstanding principal balance. Loan origination fees, net of certain direct origination costs, are recognized at the time the loan is placed on the books.

The accrual of interest on loans is discontinued when there is a clear indication that the borrower may not be able to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining book balance of the asset is deemed to be collectible. If collectability is questionable, then cash payments are applied to principal. A loan is placed back on accrual status when both principal and interest are current and it is probable that the Corporation will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses

The allowance for loan losses (“allowance”) is an amount that management believes will be appropriate to absorb estimated losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio. The allowance for loan losses is evaluated on a regular basis by management and is based upon management’s periodic review of the uncollectibility of loans in light of historical experience, the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, current economic conditions that may affect the borrower’s ability to pay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. This evaluation does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Corporation’s allowance for loan losses, and may require the Corporation to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. For such loans that are classified as impaired, an allowance is established when the collateral value, present value of expected future cash flows or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. The qualitative factors considered by management include, among other factors, (1) changes in local and national economic conditions; (2) changes in asset quality; (3) changes in loan portfolio volume; (4) the composition and concentrations of credit; (5) the trends associated with the composition of the loan portfolio; (6) the trends related to classified assets and (7) effectiveness of the Corporation’s loan policies, procedures and internal controls.

Management considers a loan to be impaired when it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered impaired, the amount of impairment is measured based on the present value of expected future cash flows discounted at the loan’s effective interest rate. If the loan is collateral-dependent, the fair value of the collateral is used to determine the amount of impairment. Impairment losses are included in the allowance for loan losses through a charge to the provision for loan losses. Impaired loans are charged off against the allowance when such loans are deemed to be uncollectible. Subsequent recoveries are added to the allowance.

When a loan is considered impaired, cash receipts are applied under the contractual terms of the loan agreement, first to principal and then to interest income. Once the recorded principal balance has been reduced to zero, future cash receipts are recognized as interest income, to the extent that any interest has not been recognized. Any further cash receipts are recorded as recoveries of any amount previously charged off.

The ultimate ability to collect a substantial portion of the Corporation’s loan portfolio is susceptible to changes in economic and market conditions in the geographic area served by the Corporation and various other factors.

Troubled Debt Restructurings

The Corporation designates loan modifications as troubled debt restructurings (“TDRs”) when for economic and legal reasons related to the borrower’s financial difficulties, it grants a concession to the borrower that it would not otherwise consider. TDRs can involve loans remaining on nonaccrual, moving to nonaccrual, or continuing on accrual status, depending on the individual facts and circumstances of the borrower. In circumstances where the TDR involves charging off a portion of the loan balance, the Corporation typically classifies these restructurings as nonaccrual.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Troubled Debt Restructurings (Continued)

In connection with restructurings, the decision to maintain a loan that has been restructured on accrual status is based on a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. This evaluation includes consideration of the borrower's current capacity to pay, which among other things may include a review of the borrower's current financial statements, an analysis of global cash flow sufficient to pay all debt obligations, a debt to income analysis, and an evaluation of secondary sources of payment from the borrower and any guarantors. This evaluation also includes an evaluation of the borrower's current willingness to pay, which may include a review of past payment history, an evaluation of the borrower's willingness to provide information on a timely basis, and consideration of offers from the borrower to provide additional collateral or guarantor support. The credit evaluation also reflects consideration of the borrower's future capacity and willingness to pay, which may include evaluation of cash flow projections, consideration of the adequacy of collateral to cover all principal and interest, and trends indicating improving profitability and collectability of receivables.

Restructured nonaccrual loans may be returned to accrual status based on a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. This evaluation must include consideration of the borrower's sustained historical repayment for a reasonable period, generally a minimum of six months, prior to the date on which the loan is returned to accrual status.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

Other Real Estate Owned

Other real estate owned represents property acquired through foreclosure or deeded to the Corporation in lieu of foreclosure on real estate mortgage loans on which borrowers have defaulted. Other real estate owned is carried at the lower of cost or fair value, adjusted for estimated selling costs. Reductions in the balance of other real estate owned at the date of foreclosure are charged to the allowance for loan losses. Subsequent valuation decreases in the carrying value of other real estate owned as well as costs to carry other real estate owned are recognized as charges to noninterest expense.

Income Taxes

The Corporation accounts for income taxes in accordance with income tax accounting guidance (FASB ASC 740, *Income Taxes*). The Corporation applies the accounting guidance related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions.

The Corporation accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period of change.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes (Continued)

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets may be reduced by deferred tax liabilities and a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Stock Based Compensation

At December 31, 2013, the Corporation had stock options and other equity awards outstanding as defined by two stock-based employee compensation plans, which are described more fully in Note 12. The Corporation accounts for its stock based compensation plans under stock compensation accounting guidance (FASB ASC 718, *Compensation – Stock compensation*). This guidance requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. For awards with graded-vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. A Black-Scholes model is used to estimate the fair value of stock options, while the market price of the Corporation's common stock at the date of grant is used for restricted stock awards and stock grants.

Earnings per Share

FASB ASC 260, *Earnings Per Share*, provides for the computation of basic and diluted earnings per share. There was no dilutive effect for the years ended December 31, 2013 and 2012, because the exercise price of the stock awards, described in Note 12, was greater than the fair value of the stock on the respective dates. Therefore, the adjustment related to share-based awards would be anti-dilutive and are not computed.

Derivative Financial Instruments

The Corporation maintains an overall interest-rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest-rate volatility. The Corporation's goal is to manage interest-rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net interest margin is not, on a material basis, adversely affected by movements in interest rates. As a result of interest-rate fluctuations, hedged assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation will generally be offset by income or loss on the derivative instruments that are linked to the hedged assets and liabilities. The Corporation views this strategy as a prudent management of interest-rate sensitivity, such that earnings are not exposed to undue risk presented by changes in interest rates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derivative Financial Instruments (Continued)

All derivatives are recognized on the balance sheet at their fair value. Derivative instruments that are used as part of the Corporation's interest-rate risk management strategy include interest rate caps. An interest rate cap will convert the variable interest rate on the Corporation's variable rate note payable to trust to fixed interest rates should interest rates rise above a specified level. On the date the interest rate cap contract is entered into, the Corporation designates the derivative as a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability "cash flow" hedge. Changes in the fair value of a derivative that is highly effective as - and that is designated and qualifies as - a cash-flow hedge are recorded in other comprehensive income (loss), until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable-rate asset or liability are recorded in earnings).

Comprehensive Income (Loss)

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net earnings. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities and cash flow hedges, are reported as a separate component of the equity section of the balance sheet, such items, along with net earnings, are components of comprehensive income (loss).

NOTE 2. CASH AND DUE FROM BANKS

The Bank is required by the Federal Reserve Bank to maintain daily cash balances. The Bank was not required to hold a daily cash balance as of December 31, 2013. The required balance was \$1,069,000 at December 31, 2012.

NOTE 3. INVESTMENT SECURITIES

The amortized cost and fair value of investment securities available for sale at December 31, 2013 and 2012 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale				
December 31, 2013:				
U.S. Treasury securities	\$ 1,027,909	\$ 4,904	\$ -	\$ 1,032,813
U.S. government sponsored agencies	107,032,239	246,627	(1,998,124)	105,280,742
State and political subdivisions	4,537,277	68,180	(89,144)	4,516,313
Mortgage-backed securities	7,647,880	-	(531,233)	7,116,647
Equity securities	10,153	4,122	-	14,275
	<u>\$ 120,255,458</u>	<u>\$ 323,833</u>	<u>\$ (2,618,501)</u>	<u>\$ 117,960,790</u>
December 31, 2012:				
U.S. Treasury securities	\$ 1,041,313	\$ 8,062	\$ -	\$ 1,049,375
U.S. government sponsored agencies	88,085,670	1,014,360	(33,603)	89,066,427
State and political subdivisions	6,815,913	318,429	(11,468)	7,122,874
Equity securities	10,153	2,502	-	12,655
	<u>\$ 95,953,049</u>	<u>\$ 1,343,353</u>	<u>\$ (45,071)</u>	<u>\$ 97,251,331</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3. INVESTMENT SECURITIES (Continued)

Those investment securities classified as available for sale which have an unrealized loss position at December 31, 2013 and 2012 are detailed below:

	Less Than Twelve Months		Over Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
December 31, 2013:						
U.S. government sponsored agencies	\$ (1,806,222)	\$ 59,290,141	\$ (191,902)	\$ 3,833,472	\$ (1,998,124)	\$ 63,123,613
Mortgage-backed securities	(531,233)	7,116,647	-	-	(531,233)	7,116,647
State and political subdivisions	(23,979)	842,831	(65,165)	264,835	(89,144)	1,107,666
Total securities	<u>\$ (2,361,434)</u>	<u>\$ 67,249,619</u>	<u>\$ (257,067)</u>	<u>\$ 4,098,307</u>	<u>\$ (2,618,501)</u>	<u>\$ 71,347,926</u>
December 31, 2012:						
U.S. government sponsored agencies	\$ (33,603)	\$ 7,219,849	\$ -	\$ -	\$ (33,603)	\$ 7,219,849
State and political subdivisions	-	-	(11,468)	318,533	(11,468)	318,533
Total securities	<u>\$ (33,603)</u>	<u>\$ 7,219,849</u>	<u>\$ (11,468)</u>	<u>\$ 318,533</u>	<u>\$ (45,071)</u>	<u>\$ 7,538,382</u>

The unrealized losses in investment securities available for sale at December 31, 2013 and 2012 were attributable to changes in market interest rates since the securities were purchased. The Corporation systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) duration and magnitude of the decline in value, (2) the financial condition of the issuer or issuers, (3) structure of the security and (4) the Corporation's intent to sell the security or whether it is more likely than not that the Corporation would be required to sell the security before its anticipated recovery in market value. Because the Corporation does not currently intend to sell the investment securities and it is not more likely than not that the Corporation will be required to sell the investment securities before recovery of their amortized cost bases, which may be maturity, the Corporation does not consider these investment securities to be other-than-temporarily impaired at December 31, 2013.

The amortized cost and fair value of investment securities available for sale at December 31, 2013, categorized by contractual maturity are shown below.

	Securities Available for Sale	
	Amortized Cost	Fair Value
Due in one year or less	\$ 12,206,099	\$ 12,250,763
Due after one year through five years	54,100,465	53,757,152
Due after five years through ten years	29,642,713	28,438,478
Due after ten years	24,306,181	23,514,397
	<u>\$ 120,255,458</u>	<u>\$ 117,960,790</u>

The gross gains and gross losses realized by the Corporation from sales of investment securities available for sale for the years ended December 31, 2013 and 2012 were as follows:

	Years Ended December 31,	
	2013	2012
Gross gains	\$ 390,026	\$ 941,572
Gross losses	-	-
Net realized gains	<u>\$ 390,026</u>	<u>\$ 941,572</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3. INVESTMENT SECURITIES (Continued)

Investment securities available for sale with fair values of \$25,929,329 and \$24,480,886 at December 31, 2013 and 2012, respectively, were pledged to secure federal funds lines, Federal Home Loan Bank advances, and public and trust deposits as required by law and for other purposes.

Restricted equity securities (included in other assets in the consolidated balance sheets) consist of the following as of December 31, 2013 and 2012:

	December 31,	
	2013	2012
Federal Home Loan Bank stock	\$ 603,500	\$ 713,200
First National Bankers' Bank stock	825,000	825,000
	\$ 1,428,500	\$ 1,538,200

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES

At December 31, 2013 and 2012, the composition of the loan portfolio was as follows:

	December 31,	
	2013	2012
Real estate:		
Construction and land loans	\$ 23,067,471	\$ 30,289,382
Farmland	27,949,945	34,871,688
1-4 family residential mortgages	53,405,723	57,024,018
Multifamily	4,109,625	4,220,311
Commercial	74,627,955	76,125,690
Agricultural	24,366,147	19,116,550
Commercial	23,831,655	24,468,370
Consumer	16,116,843	14,564,688
States and political subdivisions	4,838,258	3,926,536
Other loans	23,437	12,782
Total	\$ 252,337,059	\$ 264,620,015

As of December 31, 2013 and 2012, approximately 50% and 51%, respectively, of the Corporation's loans were commercial loans. The Corporation's commercial customers are primarily small to middle market enterprises. The Corporation also specializes in agricultural loans, including loans secured by farmland, which represented approximately 21% and 20% of the Corporation's total loans at December 31, 2013 and 2012, respectively.

Portfolio Segmentation

For purposes of the disclosures required pursuant to ASC 310, the loan portfolio was disaggregated into segments and then further disaggregated into classes for certain disclosures. A portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for loan losses. There are five primary loan portfolio segments that include real estate, agriculture, commercial, consumer and state and political subdivisions. A class is generally determined based on the initial measurement attribute, risk characteristic of the loan, and an entity's method for monitoring and assessing credit risk. Classes within the real estate portfolio segment include construction and land loans, farmland, 1-4 family residential mortgages, multifamily, and commercial. The portfolio segments of all other non-real estate loans have not been further segregated by class.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Portfolio Segmentation (Continued)

The following describe risk characteristics relevant to each of the portfolio segments:

Real Estate - As discussed below, the Corporation offers various types of real estate loan products. All loans within this portfolio segment are particularly sensitive to the valuation of real estate:

- Construction and land loans are repaid through cash flow related to the operation, sale or refinance of the underlying property. This portfolio segment includes extensions of credit to real estate developers or investors where repayment is dependent on the sale of the real estate or income generated from the real estate collateral.
- 1-4 family residential mortgages and farmland loans are repaid by various means such as a borrower's income, sale of the property, or rental income derived from the property.
- Commercial loans include owner-occupied commercial real estate loans and loans secured by income producing properties. Owner-occupied commercial real estate loans to operating businesses are long-term financing of land and buildings. These loans are viewed primarily as cash flow loans and the repayment of these loans is largely dependent on the successful operation of the business. Real estate loans for income-producing multifamily properties such as apartment buildings, office and industrial buildings, and retail shopping centers are repaid from rent income derived from the properties.

Agricultural and Commercial - These loans include those loans to agricultural and commercial customers for use in normal business operations to finance working capital needs, crop production, equipment purchases, or expansion projects. Loans are repaid by business and farming cash flows. Collection risk in this portfolio is driven by the creditworthiness of the underlying borrower, particularly cash flows from the borrowers' business operations.

Consumer - The consumer loan portfolio segment includes direct consumer installment loans, overdrafts and other revolving credit loans. Loans in this portfolio are sensitive to unemployment and other key consumer economic measures.

State and political subdivisions - The state and political subdivision loan portfolio segment includes loans to local municipalities to support municipal operations and projects. Loans are repaid generally from tax revenues collected in those municipalities.

Credit Risk Management

The Corporation assigns a risk rating to each loan when approved. The rating categories are based on information about the ability of borrowers to service the debt. Such information includes, among other things, current financial information, payment history, credit documentation and current economic conditions. Loan Officers are expected and required to initiate recommendations for changes in assigned risk ratings according to changes in the overall levels of risk in each loan in their portfolio no less than monthly. The current risk rating will be reviewed from time to time by the Chief Credit Officer and the Special Assets Officer for concurrence. The Corporation uses the following guidelines in determining the appropriate risk rating:

Grade 1: Investment Grade – There is an absence of credit risk. Loans in this category are fully secured by United Bank certificates of deposit or savings accounts (demand deposit accounts are not eligible as collateral). The certificate should be sufficient in amount to cover principal and interest.

Grade 2: Minimal Credit Risk – The overall financial condition is very strong. Businesses should have high liquidity, a history of stable and predictable earnings, a strong management team and the primary source of repayment is clear and subject to little risk. Customers should have a substantial net worth in liquid assets with a well defined source of repayment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Risk Management (Continued)

Grade 3: Attractive Credit Risk – The overall financial condition is good. Financial statements are current and show satisfactory income, profits, cash flow, and debt service coverage, debt to worth ratio and credit history. Loans in this category are properly structured and documented and require only minimal supervision.

Grade 4: Average Risk – The overall financial condition is average. Credit history has been satisfactory. Refinancing could be obtained with normal effort. Financial statements are current and show some volatility in income, profits, cash flow, debt service coverage or credit history. The volatility is easily identifiable and has been addressed and does not constitute an unwarranted level of risk.

Grade 5: Acceptable Risk – The overall financial condition of the business or individual is acceptable. There is more than average credit risk and the credit should be more closely watched but there is little chance of loss. While acceptable, loans in this category may warrant close monitoring for any number of reasons including inconsistent earnings, leveraged balance sheet, economic conditions, collateral requiring close supervision, financial information that is stale or incomplete or irregular payment record.

Grade 6: Monitor – This asset has potential weakness and deserves management attention. If left uncorrected the potential weakness may result in deterioration of the overall financial condition. There is no room for debt expansion and they are fully leveraged. If liquidation were to take place there could be a minimal loss and thus an analysis should be made to determine if a specific reserve is needed.

Grade 7: Substandard – This asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged. Loans in this category involve more than a normal risk. There is limited opportunity to refinance. If liquidation were to take place there could be some recognized loss exposure. If the loan is determined to be impaired, an analysis will be performed to determine the amount of reserve, if any, to be recognized.

Grade 8: Doubtful – A loss is highly likely and there probably will be a default. There is no ability to refinance. At this point collection effort should be in full process. Loans in this category will be reserved at a specific amount in line with the impairment analysis performed if the loan is determined to be impaired.

These risk ratings are summarized into categories as follows: Pass includes loans with Grades 1-5, Special Mention includes loans with a Grade of 6, and Substandard/Doubtful include loans with Grades 7 and 8.

The following tables summarize the credit risk profile of our loan portfolio by internally assigned grades as of December 31, 2013 and 2012.

	Pass	Special Mention	Substandard/ Doubtful	Total
	<i>(Dollars in Thousands)</i>			
December 31, 2013:				
Real estate:				
Construction and land loans	\$ 17,536	\$ 1,288	\$ 4,244	\$ 23,068
Farmland	23,826	3,365	759	27,950
1-4 family residential mortgages	49,918	2,852	636	53,406
Multifamily	4,110	-	-	4,110
Commercial	63,870	6,813	3,945	74,628
Agricultural	22,157	1,611	598	24,366
Commercial	22,573	466	793	23,832
Consumer	16,025	73	18	16,116
States and political subdivisions	4,838	-	-	4,838
Other loans	23	-	-	23
Total	<u>\$ 224,876</u>	<u>\$ 16,468</u>	<u>\$ 10,993</u>	<u>\$ 252,337</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Risk Management (Continued)

Approximately \$506,000 of the \$10,993,000 identified as Substandard/Doubtful above was considered Doubtful as of December 31, 2013.

	Pass	Special Mention	Substandard/ Doubtful	Total
	<i>(Dollars in Thousands)</i>			
December 31, 2012:				
Real estate:				
Construction and land loans	\$ 19,367	\$ 2,995	\$ 7,927	\$ 30,289
Farmland	27,294	6,276	1,302	34,872
1-4 family residential mortgages	53,204	3,586	234	57,024
Multifamily	4,220	-	-	4,220
Commercial	60,741	8,849	6,536	76,126
Agricultural	15,554	2,928	635	19,117
Commercial	19,773	3,943	752	24,468
Consumer	14,473	67	25	14,565
States and political subdivisions	3,926	-	-	3,926
Other loans	13	-	-	13
Total	\$ 218,565	\$ 28,644	\$ 17,411	\$ 264,620

Approximately \$518,000 of the \$17,411,000 identified as Substandard/Doubtful above were considered Doubtful as of December 31, 2012.

Allowance for Loan Losses

Changes in the allowance for loan losses are as follows:

	Beginning Balance	Charge-offs	Recoveries	Provision Allocation	Ending Balance
	<i>(Dollars in Thousands)</i>				
December 31, 2013:					
Real estate:					
Construction and land loans	\$ 1,485	\$ (363)	\$ 4	\$ 43	\$ 1,169
Farmland	356	(172)	12	(16)	180
1-4 family residential mortgages	543	(105)	24	(2)	460
Multifamily	10	-	-	-	10
Commercial	1,145	(505)	12	346	998
Agriculture	138	-	3	(52)	89
Commercial	647	(25)	5	59	686
Consumer	166	(128)	29	120	187
States and political subdivisions	9	-	-	3	12
Other loans	2	(2)	4	(3)	1
Total:	\$ 4,501	\$ (1,300)	\$ 93	\$ 498	\$ 3,792

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Allowance for Loan Losses (Continued)

	Beginning Balance	Charge-offs	Recoveries	Provision Allocation	Ending Balance
<i>(Dollars in Thousands)</i>					
December 31, 2012:					
Real estate:					
Construction and land loans	\$ 1,933	\$ (1,366)	\$ 6	\$ 912	\$ 1,485
Farmland	243	-	-	113	356
1-4 family residential mortgages	387	(322)	20	458	543
Multifamily	9	-	-	1	10
Commercial	1,412	(709)	25	417	1,145
Agriculture	159	-	4	(25)	138
Commercial	593	(171)	9	216	647
Consumer	155	(118)	18	111	166
States and political subdivisions	9	-	-	-	9
Other loans	2	(5)	3	2	2
Total:	<u>\$ 4,902</u>	<u>\$ (2,691)</u>	<u>\$ 85</u>	<u>\$ 2,205</u>	<u>\$ 4,501</u>

	Loan Balances			Allowance for Loan Loss		
	Total Loans	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Specific Reserves	General Reserves	Total Reserves
<i>(Dollars in Thousands)</i>						
December 31, 2013:						
Real estate:						
Construction and land loans	\$ 23,068	\$ 3,137	\$ 19,931	\$ 290	\$ 879	\$ 1,169
Farmland	27,950	1,014	26,936	57	123	180
1-4 family residential mortgages	53,406	876	52,530	-	460	460
Multifamily	4,110	-	4,110	-	10	10
Commercial	74,628	4,785	69,843	185	813	998
Agriculture	24,366	1,244	23,122	-	89	89
Commercial	23,832	577	23,255	253	433	686
Consumer	16,116	-	16,116	-	187	187
States and political subdivisions	4,838	-	4,838	-	12	12
Other loans	23	-	23	-	1	1
Total:	<u>\$ 252,337</u>	<u>\$ 11,633</u>	<u>\$ 240,704</u>	<u>\$ 785</u>	<u>\$ 3,007</u>	<u>\$ 3,792</u>

December 31, 2012:						
Real estate:						
Construction and land loans	\$ 30,289	\$ 7,739	\$ 22,550	\$ 514	\$ 971	\$ 1,485
Farmland	34,872	841	34,031	260	96	356
1-4 family residential mortgages	57,024	908	56,116	1	542	543
Multifamily	4,220	-	4,220	-	10	10
Commercial	76,126	6,866	69,260	483	662	1,145
Agriculture	19,117	1,288	17,829	-	138	138
Commercial	24,468	646	23,822	259	388	647
Consumer	14,565	-	14,565	-	166	166
States and political subdivisions	3,926	-	3,926	-	9	9
Other loans	13	-	13	-	2	2
Total:	<u>\$ 264,620</u>	<u>\$ 18,288</u>	<u>\$ 246,332</u>	<u>\$ 1,517</u>	<u>\$ 2,984</u>	<u>\$ 4,501</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loans

A loan is considered impaired when, based on current information and events; it is probable that the Corporation will be unable to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

The following tables detail the Corporation's impaired loans, by portfolio class, as of December 31, 2013 and 2012.

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
<i>(Dollars in Thousands)</i>					
December 31, 2013:					
With no related allowance recorded:					
Real estate:					
Construction and land loans	\$ 1,795	\$ 2,313	\$ -	\$ 2,704	\$ 56
Farmland	532	925	-	360	-
1-4 family residential mortgages	876	876	-	867	49
Multifamily	-	-	-	-	-
Commercial	3,259	3,399	-	3,910	154
Agriculture	1,244	1,244	-	1,266	64
Commercial	71	2,039	-	102	1
Consumer	-	-	-	-	-
States and political subdivisions	-	-	-	-	-
Other loans	-	-	-	-	-
Total with no related allowance recorded	<u>7,777</u>	<u>10,796</u>	<u>-</u>	<u>9,209</u>	<u>324</u>
With an allowance recorded:					
Real estate mortgages:					
Construction and land loans	1,342	1,789	290	1,629	47
Farmland	482	482	57	597	25
1-4 family residential mortgages	-	-	-	26	-
Multifamily	-	-	-	-	-
Commercial	1,526	1,526	185	2,197	10
Agriculture	-	-	-	-	-
Commercial	506	506	253	512	-
Consumer	-	-	-	-	-
States and political subdivisions	-	-	-	-	-
Other loans	-	-	-	-	-
Total with an allowance recorded	<u>3,856</u>	<u>4,303</u>	<u>785</u>	<u>4,961</u>	<u>82</u>
Total impaired loans:	<u>\$ 11,633</u>	<u>\$ 15,099</u>	<u>\$ 785</u>	<u>\$ 14,170</u>	<u>\$ 406</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loans (Continued)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2012:					
With no related allowance recorded:					
Real estate:					
Construction and land loans	\$ 5,907	\$ 8,545	\$ -	\$ 3,167	\$ 56
Farmland	-	-	-	-	-
1-4 family residential mortgages	779	779	-	743	31
Multifamily	-	-	-	-	-
Commercial	4,285	4,326	-	2,514	126
Agriculture	1,288	1,288	-	1,387	71
Commercial	129	2,098	-	170	2
Consumer	-	-	-	-	-
States and political subdivisions	-	-	-	-	-
Other loans	-	-	-	-	-
Total with no related allowance recorded	<u>12,388</u>	<u>17,036</u>	<u>-</u>	<u>7,981</u>	<u>286</u>
With an allowance recorded:					
Real estate mortgages:					
Construction and land loans	1,832	2,569	514	5,683	11
Farmland	841	841	260	566	15
1-4 family residential mortgages	129	129	1	214	3
Multifamily	-	-	-	-	-
Commercial	2,581	2,901	483	3,876	70
Agriculture	-	-	-	-	-
Commercial	517	517	259	662	-
Consumer	-	-	-	-	-
States and political subdivisions	-	-	-	-	-
Other loans	-	-	-	-	-
Total with an allowance recorded	<u>5,900</u>	<u>6,957</u>	<u>1,517</u>	<u>11,001</u>	<u>99</u>
Total impaired loans:	<u>\$ 18,288</u>	<u>\$ 23,993</u>	<u>\$ 1,517</u>	<u>\$ 18,982</u>	<u>\$ 385</u>

If impaired loans had been current throughout their terms, interest income would have been increased by \$193,682 and \$420,501, for the years ended December 31, 2013 and 2012, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Past Due Loans

The table below provides an age analysis of past due loans as of December 31, 2013 and 2012:

	Past Due Status (Accruing Loans)						Non-accrual	Total
	Current	30-59 Days	60-89 Days	90+ Days	Total Past Due			
<i>(Dollars in Thousands)</i>								
December 31, 2013:								
Real estate:								
Construction and land loans	\$ 22,013	\$ 108	\$ -	\$ -	\$ 108	\$ 947	\$ 23,068	
Farmland	27,051	237	-	-	237	662	27,950	
1-4 family residential mortgages	52,044	609	453	211	1,273	89	53,406	
Multifamily	4,110	-	-	-	-	-	4,110	
Commercial	72,397	407	635	-	1,042	1,189	74,628	
Agriculture	24,345	21	-	-	21	-	24,366	
Commercial	22,994	43	81	18	142	696	23,832	
Consumer	15,942	98	43	14	155	19	16,116	
States and political subdivisions	4,838	-	-	-	-	-	4,838	
Other loans	23	-	-	-	-	-	23	
Total:	\$ 245,757	\$ 1,523	\$ 1,212	\$ 243	\$ 2,978	\$ 3,602	\$ 252,337	
December 31, 2012:								
Real estate:								
Construction and land loans	\$ 24,063	\$ 271	\$ 454	\$ 129	\$ 854	\$ 5,372	\$ 30,289	
Farmland	33,865	325	-	-	325	682	34,872	
1-4 family residential mortgages	55,696	901	215	130	1,246	82	57,024	
Multifamily	4,220	-	-	-	-	-	4,220	
Commercial	72,065	100	1,043	-	1,143	2,918	76,126	
Agriculture	19,117	-	-	-	-	-	19,117	
Commercial	23,291	171	311	23	505	672	24,468	
Consumer	14,475	66	15	2	83	7	14,565	
States and political subdivisions	3,926	-	-	-	-	-	3,926	
Other loans	13	-	-	-	-	-	13	
Total:	\$ 250,731	\$ 1,834	\$ 2,038	\$ 284	\$ 4,156	\$ 9,733	\$ 264,620	

Related Party Transactions

Certain executive officers and directors of the Corporation, including their immediate families and companies with which they are associated, are loan customers of the Bank. Total loans outstanding and available lines of credit to these related parties at December 31, 2013 and 2012, totaled \$5,007,475 and \$5,104,071, respectively. Such loans are made in the ordinary course of business at normal credit terms, including interest rate and collateral requirements, and do not represent more than a normal credit risk.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Troubled Debt Restructurings

Restructured loans are loans on which, because of a borrower's financial difficulties, the Corporation has granted a concession that would not otherwise be considered. Modifications of terms that could potentially qualify as a restructuring include reduction of contractual interest rate, extension of the maturity date at a contractual interest rate lower than the current market rate for new debt with similar risk, or a reduction of the face amount of debt, or either forgiveness of either principal or accrued interest.

The following table summarizes, as of December 31, 2013 and 2012, loans that have been restructured:

	Troubled-Debt Restructurings			Effect on the Allowance for Loan Losses
	Number of Loans	Recorded Investment Prior to Modification	Recorded Investment After Modification	
<i>(Dollars in Thousands)</i>				
December 31, 2013:				
Real estate:				
Construction and land loans	4	\$ 2,524	\$ 1,275	\$ (30)
Farmland	1	511	482	-
1-4 family residential mortgages	2	371	316	-
Multifamily	-	-	-	-
Commercial	4	1,142	1,173	-
Agricultural	2	1,340	1,245	-
Commercial	4	863	599	(6)
Consumer	1	-	19	-
States and political subdivisions	-	-	-	-
Other loans	-	-	-	-
Total	18	\$ 6,751	\$ 5,109	\$ (36)
December 31, 2012:				
Real estate:				
Construction and land loans	6	\$ 6,966	\$ 4,726	\$ (426)
Farmland	2	665	637	1
1-4 family residential mortgages	3	533	471	-
Multifamily	-	-	-	-
Commercial	4	2,192	2,139	115
Agricultural	3	1,353	1,289	-
Commercial	5	878	657	6
Consumer	-	-	-	-
States and political subdivisions	-	-	-	-
Other loans	-	-	-	-
Total	23	\$ 12,587	\$ 9,919	\$ (304)

The Corporation has not forgiven any principal on the above loans. At December 31, 2013 and 2012, \$812,078 and \$5,321,860, respectively, of the above restructured loans were held as non-accrual.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Troubled Debt Restructurings (Continued)

The following tables summarize, as of December 31, 2013 and 2012, loans that were restructured within the last 12 months of each year that have subsequently defaulted:

	Troubled-Debt Restructurings		
	Number of Loans	Recorded Investment	Effect on the Allowance for Loan Losses
December 31, 2013:	<i>(Dollars in Thousands)</i>		
Real estate:			
Construction and land loans	\$ 3	\$ 306	\$ (30)
Farmland	-	-	-
1-4 family residential mortgages	-	-	-
Multifamily	-	-	-
Commercial	-	-	-
Agricultural	-	-	-
Commercial	-	-	-
Consumer	-	-	-
States and political subdivisions	-	-	-
Other loans	-	-	-
Total	<u>\$ 3</u>	<u>\$ 306</u>	<u>\$ (30)</u>
December 31, 2012:			
Real estate:			
Construction and land loans	\$ 5	\$ 3,745	\$ (426)
Farmland	1	144	1
1-4 family residential mortgages	-	-	-
Multifamily	-	-	-
Commercial	1	23	150
Agricultural	-	-	-
Commercial	1	5	6
Consumer	-	-	-
States and political subdivisions	-	-	-
Other loans	-	-	-
Total	<u>\$ 8</u>	<u>\$ 3,917</u>	<u>\$ (269)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5. OTHER REAL ESTATE OWNED

The table below presents a summary of the activity related to other real estate owned for the years ending December 31, 2013 and 2012, respectively.

	December 31,	
	2013	2012
Balance, beginning of year	\$ 8,198,175	\$ 9,946,107
Additions	4,888,904	1,715,772
Sales proceeds	(927,084)	(1,964,419)
Internally financed sales	(1,767,376)	(238,545)
Gain on sales of other real estate owned	81,788	56,260
Provision for other real estate owned losses	(775,918)	(1,317,000)
Balance, end of year	\$ 9,698,489	\$ 8,198,175

Expenses applicable to other real estate owned for the year ended December 31, 2013 and 2012 are as follows:

	Years Ended December 31,	
	2013	2012
Net gain on sales of other real estate owned	\$ (81,788)	\$ (56,260)
Provision for other real estate owned losses	775,918	1,317,000
Operating expenses, net of lease income	243,765	100,853
	\$ 937,895	\$ 1,361,593

NOTE 6. PREMISES AND EQUIPMENT

At December 31, 2013 and 2012, premises and equipment were as follows:

	December 31,	
	2013	2012
Land	\$ 5,324,102	\$ 5,324,102
Buildings and leasehold improvements (depreciated over 5 to 50 years)	16,022,727	16,013,894
Furniture, fixtures, and equipment (depreciated over 3 to 10 years)	9,021,366	8,661,946
Automobiles (depreciated over 3 years)	98,870	157,683
	30,467,065	30,157,625
Accumulated depreciation	(15,256,276)	(14,578,334)
	\$ 15,210,789	\$ 15,579,291

Depreciation expense for the years ended December 31, 2013 and 2012 was \$885,394 and \$883,111, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7. DEPOSITS

At December 31, 2013 and 2012, deposits were as follows:

	December 31,	
	2013	2012
Noninterest-bearing accounts	\$ 158,022,852	\$ 144,790,062
NOW accounts	76,318,282	72,833,622
Money market investment accounts	25,065,094	19,251,910
Savings accounts	37,548,104	28,756,584
Time deposits:		
Time deposits less than \$100,000	79,723,636	86,964,990
Time deposits greater than \$100,000	59,221,238	62,802,878
Total deposits	\$ 435,899,206	\$ 415,400,046

At December 31, 2013 and 2012 interest expense on deposits was as follows:

	December 31,	
	2013	2012
NOW accounts	\$ 236,524	\$ 283,963
Money market investment accounts	45,798	47,720
Savings accounts	34,773	41,812
Time deposits:		
Time deposits less than \$100,000	740,272	1,088,916
Time deposits greater than \$100,000	557,278	788,526
Total deposits	\$ 1,614,645	\$ 2,250,937

At December 31, 2013, the contractual maturities of time deposits are as follows:

2014	\$ 88,512,579
2015	25,241,038
2016	10,886,624
2017	8,611,987
2018	5,692,646
	\$ 138,944,874

At December 31, 2013 and 2012, overdraft demand and savings deposits reclassified to loans totaled \$123,327 and \$244,396, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8. PARTICIPATION IN U.S. TREASURY PROGRAMS

On December 23, 2008, the Corporation issued 10,300 shares of preferred stock to the U.S. Treasury for \$10.3 million pursuant to its Capital Purchase Program (CPP). Additionally, the Corporation issued 104,040 common stock warrants to the U.S. Treasury as a condition of its participation in the CPP. The warrants have an exercise price of \$14.85 each and are immediately exercisable and expire 10 years from the date of issuance. Proceeds from this sale of the preferred stock were expected to be used for general corporate purposes, including supporting the continued, anticipated growth of the Corporation. The CPP preferred stock was non-voting, other than having class voting rights on certain matters, and paid cumulative dividends quarterly at a rate of 5% per annum for the first five years and 9% thereafter. The preferred shares were redeemable at the option of the Corporation under certain circumstances during the first three years and thereafter without restriction.

On September 3, 2010, the Corporation completed the exchange of its \$10,300,000 of preferred shares issued under the U.S. Capital Purchase Program (CPP) for a like amount of preferred shares issued under the Community Development Capital Initiative (CDCI). These shares carry essentially the same terms as the CPP shares but have the following differences. The initial dividend rate is set at 2% for the CDCI shares versus the 5% for the CPP shares resulting in preferred dividends owed by the Corporation of \$206,000 annually. In both share programs, the initial dividend rate is replaced after a period by a 9% dividend rate. Under the CDCI program, the dividend will not increase until 2018.

The exchange of preferred shares did not impact the 104,040 common stock warrants the Corporation issued to the U.S. Treasury as a condition of its participation in the CPP. The warrants have an exercise price of \$14.85 each and are immediately exercisable and expire 10 years from the date of issuance (December 23, 2018).

Based on a Black-Scholes-Merton options pricing model, the common stock warrants were assigned a fair value of \$2.55 per warrant, or \$265,303 in the aggregate, as of December 12, 2008. As a result of allocating the fair value of the preferred stock and the related common stock warrants, \$346,619 has been recorded in additional paid in capital as the discount on the preferred stock obtained above and has been accreted as a reduction in net earnings available for common shareholders through December 2013.

As noted above \$346,619 was assigned to the common stock warrants, and accordingly, \$9,953,381 (total \$10.3 million) has been assigned to the Series A preferred stock and has been accreted up to the redemption amount of \$10.3 million over the five year period ending December 2013.

During the years ended December 31, 2013 and 2012, the number of shares represented by the warrants increased by a cumulative 1,911 due to the impact of stock dividends issued.

NOTE 9. BORROWED FUNDS

The Corporation owed the Federal Home Loan Bank of Atlanta the following advances:

	December 31,	
	2013	2012
Maturity Date:		
July 2017 at 6.93%	\$ 260,000	\$ 325,000
August 2017 at 6.84%	40,875	51,775
June 2020 at 4.62%	420,333	485,000
July 2020 at 7.54%	82,291	94,791
	<u>\$ 803,499</u>	<u>\$ 956,566</u>

The weighted average interest rate as of December 31, 2013 and 2012 was 5.77% and 5.81%, respectively.

At December 31, 2013 and 2012, Federal Home Loan Bank advances were collateralized by investment securities with carrying values of \$1,022,027 and \$2,066,889, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10. NOTE PAYABLE TO TRUST

United Bancorp Capital Trust II

In 2007, the Corporation formed a wholly-owned grantor trust to issue cumulative trust preferred securities. The grantor trust has invested the proceeds of the trust preferred securities in junior subordinated debentures of the Corporation. The junior subordinated debentures can be redeemed prior to maturity at the option of the Corporation on or after September 30, 2011. The sole assets of the guarantor trust are the Junior Subordinated Deferrable Interest Debentures of the Corporation (the Debentures) held by the grantor trust. The debentures have the same interest rate (three month LIBOR plus 1.68%, floating) as the trust preferred securities. The interest rate in effect as of December 31, 2013 was 1.93%. The Corporation has the right to defer interest payments on the Debentures at any time or from time to time for a period not exceeding 20 consecutive quarters provided that no extension period may extend beyond the stated maturity of the related Debentures. During any such extension period, distributions on the trust preferred certificates would also be deferred.

Payment of periodic cash distributions and payment upon liquidation or redemption with respect to the trust preferred securities are guaranteed by the Corporation to the extent of funds held by the grantor trust (the Preferred Securities Guarantee). The Preferred Securities Guarantee, when taken together with the Corporation's other obligations under the Debentures, constitute a full and unconditional guarantee, on a subordinated basis, by the Corporation of payments due on the trust preferred securities.

The trust preferred securities and the related debentures were issued on September 27, 2007. Distributions on the trust preferred securities are paid quarterly on March 31, June 30, September 30 and December 31 of each year. Interest on the Debentures is paid on the corresponding dates. The aggregate principal amount of Debentures outstanding at December 31, 2013 and 2012 was \$10,310,000.

NOTE 11. INCOME TAXES

The components of income tax expense are as follows:

	Years Ended December 31,	
	2013	2012
Current:		
Federal	\$ 280,435	\$ 35,229
State	18,251	42,693
Total	298,686	77,922
Deferred:		
Federal	461,046	272,946
State	49,822	(3,402)
Total	510,868	269,544
Income tax expense	\$ 809,554	\$ 347,466

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11. INCOME TAXES (Continued)

Total income tax expense differed from the amount computed by applying the statutory federal income tax rate of 34% to pretax income is as follows:

	Years Ended December 31,	
	2013	2012
Income tax expense at federal statutory rate	\$ 874,549	\$ 517,714
Increase (decrease) resulting from:		
Tax exempt interest	(119,704)	(157,756)
Interest disallowance	2,163	3,655
State income tax net of federal expense	44,928	25,931
Premium amortization on tax exempt investment securities	72	233
Cash surrender value of life insurance	(67,402)	(34,916)
Other, net	74,948	(7,395)
Total income tax expense	\$ 809,554	\$ 347,466

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

	December 31,	
	2013	2012
Deferred tax assets:		
Loans, principally due to the allowance for loan losses	\$ 236,559	\$ 716,737
Net operating loss carryforward	1,026,920	1,381,095
Other real estate, principally due to difference in carrying value	2,075,708	1,976,530
Intangible assets	127,727	150,288
Premises and equipment, principally due to difference in depreciation	83,054	52,029
Deferred compensation	371,868	382,975
Other comprehensive income items	932,780	-
Alternative minimum tax credit	375,412	88,402
Other	171,635	231,885
	5,401,663	4,979,941
Deferred income tax liabilities:		
Other comprehensive income items	-	476,466
Discount accretion	1,949	3,027
Other	-	(888)
	1,949	478,605
Net deferred income tax assets	\$ 5,399,714	\$ 4,501,336

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11. INCOME TAXES (Continued)

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies. Based upon the level of historical taxable income and projection for future taxable income over the periods which the temporary differences resulting in the deferred tax assets are deductible, management believes it is more likely than not that the Corporation will realize the benefits of these deductible differences.

The federal and state income tax returns of the Corporation for 2010, 2011, and 2012 are subject to examination, generally for three years after they were filed.

At December 31, 2012, the Corporation had federal and state net operating loss carry forwards of approximately \$3,000,000 and \$1,114,000, respectively, which will begin to expire in 2028 and 2017, respectively.

NOTE 12. STOCK BASED COMPENSATION

Stock Options

1998 Stock Option Plan

The United Bancorporation of Alabama, Inc. 1998 Stock Option Plan (the 1998 Plan) provides for the grant of options to officers, directors, and employees of the Corporation to purchase up to an aggregate of 308,000 shares of Class A Stock. As of December 31, 2013, the 1998 Plan had terminated pursuant to its terms effective December 22, 1998.

The changes in outstanding options are as follows:

	Shares Under Option	Weighted- Average Exercise Price Per Share
Balance at December 31, 2011	14,326	\$ 16.09
Granted	-	
Expired	(10,326)	15.74
Surrendered	-	
Exercised	-	
Balance at December 31, 2012	4,000	\$ 17.00
Granted	-	
Expired	-	
Surrendered	-	
Exercised	-	
Balance at December 31, 2013	4,000	\$ 17.00

There was no intrinsic value related to option shares outstanding and exercisable for the periods ended December 31, 2013 and 2012, respectively.

At December 31, 2013, all shares were exercisable at prices between \$16.00 and \$18.00 per share. When options are exercised, par value of the shares issued is recorded as an addition to common stock, and the remainder of the proceeds (including any tax benefit, if applicable) is credited to capital surplus.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12. STOCK BASED COMPENSATION (Continued)

Stock Options (Continued)

1998 Stock Option Plan (Continued)

As of December 31, 2013 all stock options issued under the 1998 Plan were outstanding and exercisable. The details associated with these options were as follows:

Exercise Price Per Share	Shares Under Option	Weighted-Average Remaining Contractual Life in Years	Weighted-Average Exercise Price
16.00	2,000	2.0	\$ 16.00
18.00	2,000	2.6	18.00
	4,000	2.3	\$ 17.00

2007 Equity Incentive Plan

The United Bancorporation of Alabama, Inc. 2007 Equity Incentive Plan (the 2007 Plan) provides for the grant of stock options, stock appreciation rights, restricted stock awards (discussed below), performance units, or any combination thereof to officers, directors, and employees of the Corporation to purchase up to an aggregate of 308,000 shares of Class A Stock. As of December 31, 2013, 296,467 shares of stock could be granted in the future. The changes in outstanding options are as follows:

	Shares Under Option	Weighted- Average Exercise Price Per Share
Balance at December 31, 2011	4,000	\$ 14.85
Granted	-	-
Surrendered	(2,000)	14.85
Exercised	-	-
Balance at December 31, 2012	2,000	\$ 14.85
Granted	-	-
Surrendered	-	-
Exercised	-	-
Balance at December 31, 2013	2,000	\$ 14.85
Exercisable at December 31, 2013	2,000	\$ 14.85

Grant-date fair value is measured on the date of grant using an option-pricing model with market assumptions. The grant-date fair values are amortized into expense on a straight-line basis over the vesting period. The company applies the Black-Scholes-Merton option-pricing model which requires the use of highly subjective assumptions, including but not limited to, expected stock price volatility, term, dividend rates, forfeiture rates, and risk-free interest rates, which if changed can materially affect fair value estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12. STOCK BASED COMPENSATION (Continued)

Restricted Stock

As of December 31, 2013 the Corporation has awarded restricted stock grants in two formats to two distinct classes of employees. Employees with more than 20 years of service have been awarded grants with a six month balloon vesting. The expense of these awards is recorded on a straight-line basis over the six month term. The second type of grant has been awarded to senior officers of the Corporation. These grants have five year terms (60 months) with 1/3 vesting on the grant anniversary date in years 3, 4, and 5. The expense of these awards is recorded on a straight-line basis over the 60 month term. As of December 31, 2013, all of the associated stock-based compensation related to these restricted stock grants had been recognized. No restricted stock grants were made by the Corporation during 2013 or 2012.

The following tables present restricted stock activity:

	Restricted Stock Activity	Weighted- Average Fair Value
Balance at December 31, 2011	3,456	\$ 16.56
Granted	-	-
Surrendered	(451)	16.89
Vested	(2,198)	16.76
Balance at December 31, 2012	807	\$ 15.81
Granted	-	-
Surrendered	(173)	16.35
Vested	(634)	15.65
Balance at December 31, 2013	-	\$ -

The following table summarizes stock-based compensation expense for the years ended December 31, 2013 and 2012:

	Years Ended December 31,	
	2013	2012
Stock option expense	\$ 485	\$ 2,425
Restricted stock expense	5,290	21,574
Total stock based compensation expense	\$ 5,775	\$ 23,999

NOTE 13. DIVIDEND REINVESTMENT AND SHARE PURCHASE PLAN

The Corporation sponsors a dividend reinvestment and share purchase plan. Under the plan, all holders of record of common stock are eligible to participate in the plan. Participants in the plan may direct the plan administrator to invest cash dividends declared with respect to all or any portion of their common stock. Participants may also make optional cash payments that will be invested through the plan. All cash dividends paid to the plan administrator are invested within 30 days of cash dividend payment date. Cash dividends and optional cash payments will be used to purchase common stock of the Corporation in the open market, from newly-issued shares, from shares held in treasury, in negotiated transactions, or in any combination of the foregoing. The purchase price of the shares of common stock is based on the average market price. All administrative costs are borne by the Corporation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13. DIVIDEND REINVESTMENT AND SHARE PURCHASE PLAN (Continued)

For the year ended December 31, 2013, 2,319 shares were purchased under the Plan. Cash dividends of \$0.05 per share were declared on March 15, 2013 and paid on April 1, 2013. Cash dividends of \$0.06 per share were declared on December 17, 2013 and scheduled to be paid on January 17, 2014. For the year ended December 31, 2012 no shares were purchased under the Plan as there were no cash dividends declared. In place of cash dividends in 2012, the Corporation distributed 0.87% stock dividends to shareholders on January 23, 2013 and July 30, 2012.

NOTE 14. EMPLOYEE BENEFIT PLANS

401(k) Savings Plan

Under the 401(k) savings plan that became effective October 1, 2006, employees are eligible after completing ninety days of service and attaining age 20.5. Eligible employees can contribute a minimum of 1% up to 15% of salary to the plan. The Corporation contributes one dollar for each dollar the employee contributes, up to 5.5% of the employee's salary.

Contributions to the Plan charged to expense during 2013 and 2012 were \$292,090 and \$294,727, respectively.

Profit-Sharing Plan

The Corporation also maintains a profit-sharing plan for eligible employees. Eligibility requirements for this plan are the same as the 401(k) Employee Incentive Savings Plan. Benefits paid under the Plan are subject to approval by the Board of Directors each year. Contributions to the Plan charged to expense during 2013 and 2012 were \$64,478 and \$64,703, respectively.

Salary Continuation Plan

The Corporation provides a salary continuation plan providing for death and retirement benefits for certain executive officers. The present value of the estimated amounts to be paid under the plan is being accrued over the remaining service period of the executives. The expense recognized for the salary continuation plan amounted to \$74,052 and \$36,128 for the years ended December 31, 2013 and 2012, respectively. The balance of the liability for the salary continuation plan included in other liabilities at December 31, 2013 and 2012 totaled \$1,007,899 and \$933,846, respectively.

The cost of the salary continuation plan described above is being offset by earnings from bank owned life insurance policies on the executives. The balance of the policy surrender values totaled \$8,255,367 and \$3,057,126 at December 31, 2013 and 2012, respectively. Income recognized from the increase in cash surrender value on these policies totaled \$198,241 and \$102,693 for the years ended December 31, 2013 and 2012, respectively.

Employee Stock Purchase Plan

The Corporation sponsors an employee stock purchase plan which is available to all employees subject to certain minimum service requirements. The Plan is administered by a Board appointed committee which designates the offering period in which employees may purchase shares and the offering price. All administrative costs are borne by the Corporation. No shares were purchased under the Plan for the years ended December 31, 2013 and 2012, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS

The Corporation 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 (FASB ASC 820), the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Corporation's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

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

Fair Value Hierarchy

In accordance with this guidance, the Corporation 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.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS (Continued)

Assets Measured at Fair Value on a Recurring Basis

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Available for Sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The following tables present financial assets measured at fair value on a recurring basis as of December 31, 2013 and 2012, respectively:

		Fair Value Measurements at December 31, 2013 Using		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets (Liabilities) Measured at Fair Value December 31, 2013	\$	\$	\$	\$
Available for sale securities	117,960,790	1,047,088	116,913,702	-

		Fair Value Measurements at December 31, 2012 Using		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets (Liabilities) Measured at Fair Value December 31, 2012	\$	\$	\$	\$
Available for sale securities	97,251,331	1,062,030	96,189,301	-

Assets Measured at Fair Value on a Nonrecurring Basis

Following is a description of the valuation methodologies used for instruments measured at fair value on a non-recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Impaired Loans

Loan impairment is reported when full payment under the loan terms is not expected. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate, or the fair value of collateral if the loan is collateral dependent. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to require increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when Management believes the uncollectibility of a loan is confirmed. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the loan impairment as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the loan impairment as nonrecurring Level 3.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS (Continued)

Assets Measured at Fair Value on a Nonrecurring Basis (Continued)

Other Real Estate Owned

Other real estate owned is adjusted to fair value upon transfer from the loan portfolio. Subsequently, other real estate assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the other real estate as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the other real estate as nonrecurring Level 3.

The following tables present the assets carried on the consolidated balance sheets by caption and by level within the (FASB ASC 820) valuation hierarchy (as described above) as of December 31, 2013 and 2012, for which a nonrecurring change in fair value has been recorded during the year ended December 31, 2013 and 2012, respectively.

Assets (Liabilities) Measured at Fair Value December 31, 2013	Carrying Value at December 31, 2013			
	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	Impaired loans	\$ 1,985,330	\$ -	\$ 1,985,330
	Other real estate	3,425,250	-	3,425,250

Assets (Liabilities) Measured at Fair Value December 31, 2012	Carrying Value at December 31, 2012			
	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
	Impaired loans	\$ 10,292,257	\$ -	\$ 10,292,257
	Other real estate	3,774,809	-	3,774,809

Impaired loans, which are usually measured for impairment using the fair value of collateral, had a carrying amount of approximately \$11,633,358 and \$18,287,699, with a specific valuation allowance of approximately \$785,574 and \$1,516,982 at December 31, 2013 and 2012, respectively. Of the \$11,633,358 and \$18,287,699 impaired loan portfolio, \$1,985,330 and \$10,292,257 were carried at fair value as a result of charge-offs and specific valuation allowances at December 31, 2013 and 2012, respectively. The remaining \$9,648,028 and \$7,995,442 was carried at cost, as the fair value of the collateral on these loans exceeded the book value for each individual credit at December 31, 2013 and 2012, respectively. Charge-offs and changes in specific valuation allowances during 2013 on impaired loans carried at fair value resulted in no additional provision. Charge-offs and changes in specific valuation allowances during 2012 on impaired loans carried at fair value resulted in additional provision for loan losses of approximately \$1,197,384.

The Corporation considers the fair value of other real estate owned to be the liquidation value from the current appraisal. Due to the subjective nature, incorporating both observable and unobservable inputs factored into the appraisal process, including various assumptions and expectations on cash flows, all of the Corporation's other real estate owned carried at fair value are classified within Level 3 of the valuation hierarchy.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS (Continued)

Fair Value of Financial Instruments

The assumptions used in estimating the fair value of the Corporation's financial instruments are explained below. Where quoted market prices are not available, fair values are based on estimates using discounted cash flow and other valuation techniques. Discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following fair value estimates cannot be substantiated by comparison to independent markets and should not be considered representative of the liquidation value of the Corporation's financial instruments, but rather a good-faith estimate of the fair value of financial instruments held by the Corporation. FASB ASC 820 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements.

The following methods and assumptions were used by the Corporation in estimating the fair value of its financial instruments:

Cash and Short-Term Investments: Fair value approximates the carrying value of such assets.

Investment Securities and Other Securities: The fair value of investment securities is based on quoted market prices. The fair value of other securities, which includes Federal Home Loan Bank stock and other correspondent stocks, approximates their carrying value.

Loans: The fair value of loans is calculated using discounted cash flows and excludes lease-financing arrangements. The discount rates used to determine the present value of the loan portfolio are estimated market discount rates that reflect the credit and interest rate risk inherent in the loan portfolio. The estimated maturities are based on the Corporation's historical experience with repayments adjusted to estimate the effect of current market conditions.

Bank Owned Life Insurance: The fair value of bank owned life insurance approximates its carrying value.

Deposits: The fair value of deposits with no stated maturity, such as non-interest bearing demand deposits, NOW accounts, savings and money market deposit accounts, approximates the carrying value. Certificates of deposit have been valued using discounted cash flows. The discount rates used are based on estimated market rates for deposits of similar remaining maturities.

The fair value estimates in the table below do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

FHLB Advances and Note Payable to Trust: The fair value of the Corporation's note payable to trust approximates the carrying value of such liabilities. The fair value of FHLB advances have been valued using discounted cash flows. The discount rates used are based on estimated market rates for borrowings of similar remaining maturities.

Accrued Interest: The fair value of accrued interest receivable and payable approximates their carrying value.

Commitments to Extend Credit and Standby Letters of Credit: There is no market for the commitment to extend credit and standby letters of credit and they were issued without explicit cost. Therefore, it is not practical to establish their fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS (Continued)

Fair Value of Financial Instruments (Continued)

The carrying value and estimated fair value of the Corporation's financial instruments at December 31, 2013 and 2012 are as follows:

	December 31,			
	2013		2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<i>(Dollars in Thousands)</i>				
Financial assets:				
Cash and short-term investments	\$ 75,493	\$ 75,493	\$ 71,299	\$ 71,299
Investment securities	117,961	117,961	97,251	97,251
Loans held for sale	883	883	207	207
Loans held for investment, net of the allowance for loan losses	248,545	258,183	260,119	268,761
Bank owned life insurance	8,255	8,255	3,057	3,057
Other securities	1,429	1,429	1,538	1,538
Accrued interest receivable	1,858	1,858	2,061	2,061
Financial liabilities:				
Deposits	435,899	437,896	415,400	419,052
FHLB advances	803	871	957	1,088
Note payable to trust	10,310	10,310	10,310	10,310
Accrued interest payable	163	163	200	200

NOTE 16. DIVIDENDS FROM BANK

Dividends paid by the Bank are the primary source of funds available to the Corporation for payment of dividends to its stockholders and for other needs. Applicable federal and state statutes and regulations impose restrictions on the amounts of dividends that may be declared by the subsidiary bank. In addition, the subsidiary bank is also required to maintain minimum amounts of capital to both total "risk-weighted" assets and total average assets, as defined by banking regulators. Capital adequacy considerations could further limit the availability of dividends from the subsidiary bank. The payment of dividends from the Bank is regulated by the Alabama State Banking Department and may be limited based on earnings and credit losses. Future payments of dividends by the Bank to the Corporation will be dependent on earnings, loan losses and compliance with applicable regulations of the Alabama State Banking Department and applicable federal regulators.

NOTE 17. LITIGATION

The Corporation is involved in various legal proceedings arising in connection with their business. In the opinion of management, based upon consultation with legal counsel, the ultimate resolution of these proceedings is not expected to have a material adverse effect upon the financial statements of the Corporation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18. COMMITMENTS

The Corporation leases certain property and equipment for use in its business. These leases have lease terms generally not in excess of five years. The Corporation is not committed to any operating leases, which have initial or remaining noncancelable lease terms in excess of one year as of December 31, 2013.

Rental expense for all operating leases charged to earnings aggregated \$25,170 and \$40,413 for the years ended December 31, 2013 and 2012, respectively.

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such instruments involve elements of credit risk in excess of the amounts recognized in the consolidated financial statements.

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

The financial instruments whose contractual amounts represent credit risk as of December 31, 2013 and 2012 are approximately as follows:

	December 31,	
	2013	2012
Commitments to extend credit	\$ 40,839,313	\$ 36,593,000
Standby letters of credit	563,048	716,000
	<u>\$ 41,402,361</u>	<u>\$ 37,309,000</u>

Standby letters of credit are commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation holds various assets as collateral supporting those commitments for which collateral is deemed necessary.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19. OTHER NONINTEREST EXPENSE

Components of other noninterest expense exceeding 1% of the total of net interest income and noninterest income for the years ended December 31, 2013 or 2012, respectively, include the following:

	December 31,	
	2013	2012
Accounting and audit	\$ 151,044	\$ 269,375
Advertising	384,049	359,371
Armored care service	79,431	117,769
ATM network	394,011	442,937
Communications	312,717	367,315
Data processing	881,503	685,104
FDIC deposit insurance	420,544	410,136
Legal	224,224	165,370
Other real estate owned expenses	243,765	100,853
Provision for other real estate owned losses	775,918	1,317,000
Other	1,941,410	1,783,772
	\$ 5,808,616	\$ 6,019,002

NOTE 20. CONCENTRATIONS OF CREDIT RISK

On December 31, 2013, the Corporation had \$52,316,092 of agriculture related loans as compared to \$53,988,238 in 2012. Agriculture loans comprised approximately 21% of the loan portfolio. Additionally, real estate construction loans accounted for approximately 9% of the total portfolio, while 1-4 family residential mortgage loans made up approximately 21% of the portfolio. Real estate construction and 1-4 family residential mortgage loans were \$23,067,471 and \$53,405,723 respectively in 2013, \$30,289,382 and \$57,024,018, respectively, in 2012.

NOTE 21. REGULATORY MATTERS

The Corporation and its subsidiary 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 Corporation. Under capital adequacy guidelines and the regulatory framework of prompt corrective action, the Corporation and its subsidiary bank must meet specific capital guidelines that involve quantitative measures of each bank’s assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification of the Corporation and its subsidiary bank 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 Corporation and its subsidiary bank to maintain minimum core capital (Tier I Capital) of at least 4% of risk-weighted assets, minimum total capital (Total Qualifying Capital) of at least 8% of risk-weighted assets and a minimum leverage ratio of at least 4% of quarterly average assets. Management believes, as of December 31, 2013 and 2012, that the Corporation and its subsidiary bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2013, the most recent notification from the appropriate regulatory agencies categorized the subsidiary bank as “well-capitalized” under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the subsidiary bank’s category.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21. REGULATORY MATTERS (Continued)

The following table presents the actual capital amounts and ratios of the Corporation and its subsidiary bank at December 31, 2013 and 2012:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<i>(Dollars in Thousands)</i>						
December 31, 2013:						
Total Capital to Risk Weighted Assets						
United Bancorporation	\$ 48,812	16.84%	\$ 23,190	8.00%	N/A	N/A
United Bank	\$ 47,791	16.54%	\$ 23,122	8.00%	\$ 28,903	10.00%
Tier I Capital to Risk Weighted Assets						
United Bancorporation	\$ 45,194	15.59%	\$ 11,595	4.00%	N/A	N/A
United Bank	\$ 44,174	15.28%	\$ 11,561	4.00%	\$ 17,341	6.00%
Tier I Capital to Average Assets						
United Bancorporation	\$ 45,194	9.44%	\$ 19,159	4.00%	N/A	N/A
United Bank	\$ 44,174	9.23%	\$ 19,146	4.00%	\$ 23,933	5.00%
December 31, 2012:						
Total Capital to Risk Weighted Assets						
United Bancorporation	\$ 46,854	16.15%	\$ 23,211	8.00%	N/A	N/A
United Bank	\$ 46,262	15.96%	\$ 23,186	8.00%	\$ 28,982	10.00%
Tier I Capital to Risk Weighted Assets						
United Bancorporation	\$ 43,220	14.90%	\$ 11,605	4.00%	N/A	N/A
United Bank	\$ 42,628	14.71%	\$ 11,953	4.00%	\$ 17,389	6.00%
Tier I Capital to Average Assets						
United Bancorporation	\$ 43,220	9.44%	\$ 18,311	4.00%	N/A	N/A
United Bank	\$ 42,628	9.32%	\$ 18,298	4.00%	\$ 22,873	5.00%

NOTE 22. DERIVATIVE FINANCIAL INSTRUMENTS

To hedge the Corporation's exposure to changing interest rates, management entered into an agreement known as an "interest rate cap" on its variable rate note payable to trust during April 2012. Interest rate caps are typically used to mitigate a borrowing's exposure to rising interest rates. Pursuant to the agreement, the Corporation's counterparty agrees to pay the Corporation an amount equal to the difference between the three-month LIBOR and 2.50% multiplied by a \$10,000,000 notional amount should the three-month LIBOR rise above 2.50% during the five year term of the agreement. The Corporation paid its counterparty a one-time premium equal to \$158,000 which will be amortized over the five year term. The interest rate cap is being marked to market and accounted for as a cash flow hedge. As of December 31, 2013, the interest rate cap contract was carried at fair value which was equal to \$52,024.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23. PARENT CORPORATION FINANCIAL INFORMATION

The condensed financial information for United Bancorporation of Alabama, Inc. (Parent Corporation Only) follows:

CONDENSED BALANCE SHEETS

	2013	2012
Assets		
Cash	\$ 162,471	\$ 27,729
Investment in subsidiary	47,664,135	48,650,423
Other assets	485,887	280,928
Total assets	\$ 48,312,493	\$ 48,959,080
Liabilities and stockholders' equity		
Other liabilities	\$ 159,273	\$ 9,615
Note payable to trust	10,310,000	10,310,000
Total liabilities	10,469,273	10,319,615
Stockholders' equity		
Preferred stock of \$.01 par value. Authorized 250,000 shares; 10,300 shares issued in 2013 and 2012, respectively	10,300,000	10,222,501
Class A common stock of \$.01 par value. Authorized 5,000,000 shares; issued 2,390,822 and 2,388,676 shares in 2013 and 2012, respectively	23,908	23,887
Class B common stock of \$.01 par value. Authorized 250,000 shares; no shares issued	-	-
Additional paid-in capital	7,194,122	7,175,616
Unearned stock based compensation	-	(5,289)
Retained earnings	21,727,965	20,511,650
Accumulated other comprehensive income (loss), net of tax	(1,399,192)	714,683
Less: 439 treasury shares at cost in 2013 and 2012	3,583	3,583
Total stockholders' equity	37,843,220	38,639,465
Total liabilities and stockholders' equity	\$ 48,312,493	\$ 48,959,080

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23. PARENT CORPORATION FINANCIAL INFORMATION (Continued)

CONDENSED STATEMENTS OF EARNINGS

	2013	2012
Income		
Dividend income from subsidiary	\$ 908,490	\$ 570,000
Other income	6,157	6,768
Total income	914,647	576,768
Expense		
Interest on subordinated debentures	204,787	225,089
Other interest expense	9,164	-
Other operating expense	186,134	158,162
Total expense	400,085	383,251
Income before equity in undistributed earnings of subsidiary and income taxes	514,562	193,517
Income tax benefit	(145,341)	(138,905)
Income before equity in undistributed earnings of subsidiary	659,903	332,422
Equity in undistributed earnings of subsidiary	1,102,746	842,799
Net earnings	\$ 1,762,649	\$ 1,175,221

CONDENSED STATEMENTS OF CASH FLOWS

	2013	2012
OPERATING ACTIVITIES		
Net earnings	\$ 1,762,649	\$ 1,175,221
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Equity in undistributed earnings of subsidiary	(1,102,746)	(842,799)
Stock based compensation	485	2,425
Increase (decrease) in other liabilities	149,658	(25,015)
Increase in other assets	(370,762)	(126,199)
Net cash provided by operating activities	439,284	183,633
FINANCING ACTIVITIES		
Cash dividends - preferred stock	(206,000)	(206,000)
Cash dividends - common stock	(119,412)	(4,725)
Proceeds from dividend reinvestment plan	20,870	-
Net cash used in financing activities	(304,542)	(210,725)
Net increase (decrease) in cash	134,742	(27,092)
Cash at beginning of year	27,729	54,821
Cash at end of year	\$ 162,471	\$ 27,729