

**THE BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551**

FORM 10-KSB

**[X] ANNUAL REPORT UNDER SECTION 13 or 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2007

or

**[] TRANSITION REPORT UNDER SECTION 13 or 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

COLONIAL VIRGINIA BANK

(Name of small business issuer in its charter)

Virginia

(State or other jurisdiction of
incorporation or organization)

75-3093106

(I.R.S. Employer
Identification No.)

**6720 Sutton Road
Gloucester, Virginia**

(Address of principal executive offices)

23061

(Zip Code)

Issuer's telephone number: **(804) 695-9300**

Securities registered under Section 12(b) of the Exchange Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
None	n/a

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, par value \$5.00 per share
(Title of class)

Check whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. []

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. []

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

State issuer's revenues for its most recent fiscal year. \$6,494,073

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked price of such common equity, as of a specified date within the past 60 days. \$10,291,082

State the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

610,175 shares of common stock, par value \$5.00 per share,
outstanding as of March 28, 2008

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2008 Annual Meeting of Shareholders – Part III

COLONIAL VIRGINIA BANK

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PART I

Item 1. Description of Business

General

Colonial Virginia Bank (the “Bank”) was organized under the laws of the Commonwealth of Virginia to engage in commercial and retail banking business. The Bank places special emphasis on serving the financial needs of small and medium sized businesses, professional concerns and individuals in the greater Middle Peninsula, which includes the counties of Gloucester, Mathews and Middlesex, and the Peninsula, which includes the cities of Hampton, Newport News, Williamsburg and Poquoson and the counties of James City and York, regions of Virginia.

The Bank was incorporated on December 17, 2002 and commenced operations on November 6, 2003 (inception), upon receipt of final approval from the Virginia State Corporation Commission’s Bureau of Financial Institutions and the Federal Reserve Bank of Richmond. The Bank received approval for the issuance of deposit insurance from the Federal Deposit Insurance Corporation (“FDIC”) on November 6, 2003.

The Bank’s current focus is in Gloucester County, where the Bank’s headquarters are located at 6720 Sutton Road in Gloucester and the York River branch office is located at 1553 George Washington Memorial Highway (U.S. Route 17) in Gloucester Point. In the fourth quarter of 2007, the Bank received regulatory approval to establish a new branch in New Kent County, Virginia, within a planned unit development called Maidstone Village. The office will be approximately 45 miles from the current Main Office and is expected to open before the end of 2008. The Bank offers a full range of banking and related financial services, including checking, savings, certificates of deposit and other depository services, and commercial, real estate and consumer loans. The Bank is a community-oriented institution with substantial local ownership, focusing on providing a high level of responsive and personalized services to its customers, delivered in the context of a strong direct relationship between the customer and the Bank.

The Bank is subject to intense competition from existing bank holding companies, commercial banks and savings banks, which have been in business for many years and have established customer bases. Competition is increasingly coming from credit unions, whose field of membership and market expansion have benefited from loose regulatory restrictions. Credit unions were originally chartered to meet the financial needs of “people of modest means” and, as such, were granted a tax preference by Congress. This tax preference, coupled with an abandoning of existing exclusively for those of modest means, has changed dramatically the landscape of the financial services industry. Competition also comes from a variety of other non-bank businesses that offer financial services. Many of these competitors operate in the same geographic market where the Bank operates, are well-known with long-standing relationships with businesses and individuals in the communities, and are substantially larger with greater resources than the Bank.

The Bank is also subject to regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities. The Bank’s principal regulators are the Federal Reserve Bank of Richmond (“FRB”) and the Virginia State Corporation Commission’s Bureau of Financial Institutions (“BFI”). As a consequence of the extensive regulation of commercial banking activities, the Bank’s business is susceptible to state and federal legislation and regulations.

In the fourth quarter of 2005, the Bank began offering a full range of investment services, through a newly formed division of the Bank, operating as Colonial Virginia Investment Services. These services

are offered through an affiliation with Community Bankers Securities and are discussed further below in Item 6, Management's Discussion and Analysis or Plan of Operation.

The Bank entered into an agreement in the third quarter 2006 to form an independent mortgage company. The mortgage company began operations October 1, 2006 under the name of Colonial Virginia Mortgage Company, LLC ("CVM"). It is owned 50% each by the Bank and Johnson Mortgage Company, LLC of Newport News, Virginia and is discussed further below in Item 6, Management's Discussion and Analysis or Plan of Operation. CVM makes and sells whole loans and is believed to be a good complement to the Bank's overall lending program. CVM was capitalized with \$250,000, with each owner contributing \$125,000.

The Bank also participates in a joint venture arrangement through the Virginia Bankers Association providing mortgage title insurance services to customers.

The Bank has no subsidiaries.

The Bank invests in certain U.S. Government and agency obligations and other investments permitted by applicable laws and regulations. The operating results of the Bank are highly dependent on net interest income, the difference between interest income earned on loans and investments and the cost of interest-bearing deposits and borrowed funds.

Deposit accounts of the Bank, up to \$100,000, are insured by the Deposit Insurance Fund ("DIF"), administered by the FDIC. The Bank is a member of the FRB. The Bank is subject to the supervision, regulation and examination of the FRB and the DIF. The Bank is also subject to the regulations of the Board of Governors of the Federal Reserve System governing reserves required to be maintained against deposits.

Business Strategy

The Bank's officers, employees and members of the Board of Directors live and work in the Middle Peninsula and Peninsula regions, predominately in the counties of Gloucester, Mathews and Middlesex.

The Bank's Management and the Board believe that the existing and future banking market in the Middle Peninsula and Peninsula communities represents an opportunity for locally owned and locally managed community banks. In view of the continuing trend in the financial services industry toward consolidation into larger, sometimes impersonal, statewide, regional and national institutions, the market exists for the personal and customized financial services that an independent, locally owned bank can offer. With the flexibility of its smaller size and through an emphasis on relationship banking, including personal attention and service, the Bank can be more responsive to the individual needs of its customers than its larger competitors. As a community-oriented and locally owned institution, the Bank can invest the majority of its loan resources in the community and will tailor its services to meet the banking and financial needs of its customers who live and do business in the Middle Peninsula and Peninsula communities.

The Bank is engaged in a general commercial and retail banking business, serving the Middle Peninsula and Peninsula area. The Bank is currently focused on the Gloucester County market. The Bank offers a full range of banking and related financial services to individuals, small to medium sized businesses, entrepreneurs, and the professional community. The Bank is striving to develop personal banking relationships with its customers. The Bank's officers, employees and directors believe that the

marketing of customized relationship banking services enables the Bank to establish a niche in the financial services marketplace in the Middle Peninsula market.

The Bank provides its customers with high quality, responsive and technologically advanced banking services. These services include loans that are priced on a deposit-based relationship and easy access to the Bank's decision makers. The Bank's initial capitalization enables it to operate with a lending limit that should satisfy the credit needs of a large portion of its targeted market segment, which includes small businesses and individuals. The Bank's membership in the Community Bankers' Bank allows the Bank to offer loan products to customers whose loan requirements exceed the Bank's lending limit. The Bank's initial capitalization is sufficient to support current operations and provide for substantial growth in deposits and loans.

Location and Market Area

The Bank's Main Office is located at 6720 Sutton Road in Gloucester. Gloucester County is primarily a residential area with a work force commuting to other cities and counties. Several large retail establishments have operations located in Gloucester County, including a Wal-Mart Super Center, the Home Depot and Lowe's. General traffic volume and centrality of a banking location relative to recent growth trends of the market area indicate that this location will be convenient to the Bank's targeted customer base now and for the future. The Bank located its first branch ("York River") office at 1553 George Washington Memorial Highway (U.S. Route 17) in Gloucester Point, in the southern part of Gloucester County. This location is convenient to the commuting traffic patterns from the Middle Peninsula area to the Peninsula area.

In the fourth quarter of 2007, the Bank received regulatory approval to establish a new branch in New Kent County, Virginia, within a planned unit development called Maidstone Village. The office will be approximately 45 miles from the current Main Office and is expected to open before the end of 2008.

The Gloucester market area supports a diverse, well-rounded economy. Gloucester and surrounding counties are served by a modern regional hospital facility, excellent school systems, and a comprehensive communications network. The Board of Directors believes that there are an ample number of newspaper, radio and television outlets that offer diverse and broad opportunities for effective advertising and public relations for the Bank. The area has seen an active housing market with a wide variety of housing types including single-family detached homes, duplexes, townhouses, and garden apartments. Gloucester County is comprised of 225 square miles of land area and 32 square miles of water area. As of 2004, the county's estimated population is in excess of 37,000, with a projected total population in excess of 46,000, an increase of 24%, by 2010.

The Board of Directors believes that growth in the Bank's initial service area will be at least equal to growth in the greater market. The Board of Directors also anticipates that the Bank's services and products will appeal to customers in the greater Middle Peninsula and Peninsula regions, as Peninsula residents have demonstrated increased mobility and activity within Gloucester County, making them a targeted customer base. The Directors of the Bank are residents of, or work in, the greater Middle Peninsula and Peninsula regions. Their belief is based upon their review of the economic outlook for the area and the size, nature and growth potential of the existing market for banking services. While the steady growth that the greater Middle Peninsula and Peninsula regions have experienced is expected to continue in the future, no assurance can be given that such growth will continue.

Banking Services

The Bank receives deposits, makes consumer and commercial loans, issues drafts, and provides other services customarily offered by a commercial banking institution, such as business and personal checking and savings accounts, drive-in windows, and 24-hour automated teller machines. The Bank will not initially apply for permission from the Virginia State Corporation Commission to establish a trust department and offer trust services. The Bank is chartered as a state chartered commercial bank and is a member of the Federal Reserve System. Deposits are insured under the Federal Deposit Insurance Act to the limits provided there under. The Bank is independent of any affiliation with a bank holding company.

The Bank offers a full range of short-to-medium term commercial and personal loans. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements) and purchase of equipment and machinery. Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education and personal investments. The Bank originates and holds variable rate mortgage loans and real estate construction and acquisition loans. The Bank, through its subsidiary, CVM, originates and sells into the secondary market, fixed and variable rate mortgage loans.

The Bank's lending activities are subject to a variety of lending limits imposed by state law. While differing limits apply in certain circumstances based on the type of loan or the nature of the borrower (including the borrower's relationship to the Bank), in general the Bank is subject to a loans-to-one borrower limit of an amount equal to 15% of the Bank's capital and surplus in the case of loans which are not fully secured by readily marketable or other permissible types of collateral. The Bank may voluntarily choose to impose a policy limit on loans to a single borrower that is less than the legal lending limit. The Bank is a member of the Community Bankers' Bank and will participate in loans when loan amounts exceed the Bank's legal lending limits or internal lending policies.

Other services offered by the Bank include issuance of cashier's checks, certain cash management and safe deposit box services, travelers' checks, direct deposit of payroll and social security checks and automatic drafts for various accounts. The Bank is associated with a shared network of automated teller machines that may be used by Bank customers throughout Virginia and other regions. The Bank also offers MasterCard and VISA credit card services through an agent program with another financial institution.

The Bank does not currently exercise trust powers. The Bank may establish a trust department in the future but cannot do so without prior regulatory approval. In the interim, the Bank may contract for the provision of trust services to its customers through an outside vendor.

Employees

As of December 31, 2007, the Bank had 27 full-time equivalent employees and 30 total employees. None of the Bank's employees were covered by a collective bargaining agreement. The Bank considers its relationship with its employees to be good. Several employees have been associated with senior management in previous employment positions. The Bank's management believes that these long-term working relationships will continue to contribute to its growth and success.

Effect of Adverse Economic Conditions

The Bank's business may be adversely affected by periods of economic slowdown or recession which may be accompanied by decreased demand for consumer credit and declining real estate values. Any material decline in real estate values reduces the ability of borrowers to use home equity to support

borrowings and increases the loan-to-value ratios of loans previously made by the Bank, thereby weakening collateral coverage and increasing the possibility of a loss in the event of default. In addition, delinquencies, foreclosures and losses generally increase during economic slowdowns or recessions.

The Bank anticipates the majority of its depositors will be located in and doing business in the local market and the Bank will lend a substantial portion of its capital and deposits to individuals and business borrowers in this market area. Any factors adversely affecting the economy of this market could, in turn, adversely affect the performance of the Bank.

Asset/Liability Management

Management strives to manage the maturity or repricing match between assets and liabilities. The degree to which the Bank is “mismatched” in its maturities is a primary measure of interest rate risk. In periods of stable interest rates, net interest income can be increased by financing higher yielding long-term mortgage loan assets with lower cost short-term deposits and borrowings. Although such a strategy may increase profits in the short run, it increases the risk of exposure to rising interest rates and can result in funding costs rising faster than asset yields.

Interest Rate Risk

Profitability may be directly affected by the levels of and fluctuations in interest rates, which affect the Bank’s interest margin, its ability to earn a spread between interest received on its earning assets (investments and loans) and its funding costs, initially deposits garnered locally. The profitability of the Bank could change dramatically, positively or negatively, if its yield on earning assets responds differently from its funding costs in a rapid and sustained shift in interest rates.

Interest margins are affected by several factors, one of which is the relationship of rate-sensitive earning assets to rate-sensitive interest bearing liabilities. This factor determines the effect that fluctuating interest rates will have on net interest income. Rate-sensitive earning assets and interest bearing liabilities are those which can be repriced to current market rates within a relatively short time. The Bank’s objective in managing interest rate sensitivity is to achieve reasonable stability in the interest margin throughout interest rate cycles by maintaining the proper balance of rate-sensitive assets and liabilities. For further analysis and discussion of interest rate sensitivity, refer to the section entitled “Liquidity and Interest Rate Sensitivity Management” below.

An additional factor that affects the interest margin is the interest rate spread. The interest rate spread measures the difference between the average yield on interest earning assets and the average rate paid on interest bearing liabilities. This measurement is a more accurate reflection of the effect market interest rate movements have on interest rate-sensitive assets and liabilities.

The percentage of earning assets funded by interest bearing liabilities also affects the Bank’s interest margin. The Bank’s earning assets are funded by interest bearing liabilities, non-interest bearing demand deposits and shareholders’ equity. The net return on earning assets funded by non-interest bearing demand deposits and shareholders’ equity exceeds the net return on earning assets funded by interest bearing liabilities.

Asset Quality

Loans past due 30 to 89 days totaled \$700,885, or 1.31% of total loans, at December 31, 2007. Loans past due 90 days or more and still accruing interest totaled \$1,254 at December 31, 2007.

Interest on most loans is billed monthly. Interest on loans held for investment by the Bank is accrued until the loans become 90 days or more past due. Nonaccrual loans and repossessions totaled \$7,610 and \$55,000, respectively, at December 31, 2007. Total non-performing assets totaled 0.12% of total loans at December 31, 2007.

Competition

In the conduct of certain aspects of its banking business, the Bank encounters strong competition from other commercial banks, savings and loan associations, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds and other financial institutions. A number of these competitors are well-established in the Middle Peninsula and Peninsula areas. Competition for loans is keen, and pricing is important. Most of the Bank's competitors have substantially greater resources and higher lending limits than the Bank currently has and offer certain services, such as extensive and established branch networks and trust services that the Bank does not currently provide. Deposit competition also is strong, and the Bank may have to pay higher interest rates to attract deposits. General competition from the credit union community has grown in intensity in the recent past, placing even greater pressure on loan and deposit pricing. This has contributed to compression in the Bank's net interest margin. The adoption of legislation permitting nationwide interstate banking and branching could increase competition in the Bank's markets, and federal legislation recently adopted allows non-banking companies, such as insurance and investment firms, to establish or acquire banks.

The development of the Bank's business is based in large measure upon the belief that a locally owned and managed community bank can successfully compete with larger financial institutions that are not locally owned and managed. There is no assurance that the Bank will be able to continue to attract the necessary resources that are required to make the Bank profitable.

There are numerous other existing banks and financial institutions in the initial market area which are engaged in the type of business in which the Bank is engaged. The Bank competes with a variety of institutions, including other commercial banks, savings and loan associations, savings banks, credit unions, insurance companies, securities brokerage houses, and money market mutual funds for deposit accounts. Additional competition for deposits comes from corporate and governmental securities, which offer a high rate of interest. The Bank also competes with other commercial banks, savings and loan associations, savings banks, insurance companies, mortgage banking firms, and other lending institutions for origination of loans. These competitors of the Bank include larger, more established institutions, which will have available substantially greater resources, broader geographic markets and higher lending limits. The success of the Bank depends largely upon its ability to attract deposits and to make successful loans in competition with such other institutions. There can be no assurance that the competitive environment in which the Bank must operate will be favorable to the Bank's business or its plan of development. In addition, the Bank must compete with other banks and financial institutions for qualified personnel to staff its office or offices.

The Middle Peninsula and Peninsula markets, within the last several years, have experienced significant mergers or acquisitions involving several banks with branch offices located in these areas. The Bank's Management and Directors believe that the Bank can capitalize on such merger activity in the Middle Peninsula and Peninsula market areas and attract customers from those who are dissatisfied with the recently acquired banks. By initially focusing on the Gloucester County area, the Bank believes that it can compete effectively in this market. Management and the Directors believe that the area will react favorably to the Bank's community bank focus and special emphasis on relationship banking service to small and medium sized businesses, individuals, entrepreneurs, and professional concerns. As of the

most recent FDIC statistical data (June 30, 2007), the Bank had 20.17% of the total market share for Gloucester County, up from 14.22% at June 30, 2006.

Supervision and Regulation

General. The Bank is a Virginia state bank and a member of the Federal Reserve System, and its depositors are insured by the FDIC. The Federal Reserve and the Virginia State Corporation Commission and its Bureau of Financial Institutions (the “State”) regulate and monitor the Bank’s operations. The Bank is required to file with the Federal Reserve quarterly financial reports on the financial condition and performance of the organization. The Federal Reserve and the State conduct periodic onsite and offsite examinations of the Bank. The Bank must comply with a wide variety of reporting requirements and banking regulations. The laws and regulations governing the Bank generally have been promulgated to protect depositors and the deposit insurance funds and not to protect various shareholders. Additionally, the Bank must bear the cost of compliance with the reporting and regulations; these costs can be significant and have an effect on its financial performance.

The Federal Reserve, State and FDIC have the authority and responsibility to ensure that financial institutions are managed in a safe and sound manner. They have the authority to prevent the continuation of unsound and unsafe activities. Additionally, they must generally approve significant business activities undertaken by financial institutions. Typical examples of transactions requiring approval include branch locations, mergers, capital transactions and major organizational structure changes. Obtaining regulatory approval for these types of activities can be time consuming, expensive and ultimately may not be successful.

Insurance of Accounts, Assessments and Regulation by the FDIC. The Bank’s deposit accounts are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation up to the maximum legal limits of the FDIC and it is subject to regulation, supervision and regular examination by the Virginia Bureau of Financial Institutions and the Federal Reserve. The regulations of these various agencies govern most aspects of the Bank’s business, including required reserves against deposits, loans, investments, mergers and acquisitions, borrowings, dividends and location and number of branch offices. The laws and regulations governing the Bank generally have been promulgated to protect depositors and the deposit insurance funds, and not for the purpose of protecting shareholders.

The Federal Deposit Insurance Act (the FDIA) establishes a risk-based deposit insurance assessment system. Under applicable regulations, deposit premium assessments are determined based upon a matrix formed utilizing capital categories – “well capitalized,” “adequately capitalized” and “undercapitalized” - defined in the same manner as those categories are defined for purposes of Section 38 of the FDIA. Each of these groups is then divided into three subgroups which reflect varying levels of supervisory concern, from those which are considered healthy to those which are considered to be of substantial supervisory concern. On February 15, 2006, Federal legislation to reform federal deposit insurance was enacted. This new legislation required, among other things, that FDIC adopt regulations increasing the maximum amount of federal deposit insurance coverage per separately insured individual retirement savings account depositor to \$250,000 (with a cost of living adjustment to become effective in five years). The legislation also gave the FDIC greater discretion to identify the relative risks all institutions present to the deposit insurance fund and set risk-based premiums.

On November 2, 2006, the FDIC adopted final regulations establishing a risk-based assessment system that is intended to more closely tie each bank’s deposit insurance assessments to the risk it poses to the deposit insurance fund. Under the new risk-based assessment system, which became effective in the beginning of 2007, the FDIC evaluates each bank’s risk based on three primary factors: (1) its supervisory rating, (2) its financial ratios, and (3) its long-term debt issuer rating, if the bank has one.

The new rates for most banks will vary between five and seven cents for every \$100 of domestic deposits. In 2006, under prior regulations, the Bank paid only the base assessment rate for “well capitalized” institutions which amounted to \$7,289 in deposit insurance premiums. For 2007, the Bank continued to pay the base rate for “well capitalized” institutions, but the total assessments increased to \$39,961 as a result of the final regulations.

Bank Capital Adequacy Guidelines. The Federal Reserve Board has issued risk-based and leverage capital guidelines applicable to banking organizations that it supervises. Under the risk-based capital requirements, the Bank is generally required to maintain a minimum ratio of total capital to risk-weighted assets (including specific off-balance sheet activities, such as standby letters of credit) of 8%. At least half of the total capital (4%) must be composed of “Tier 1 Capital”, which is defined as common equity, retained earnings and qualifying perpetual preferred stock, less certain intangibles. The remainder may consist of “Tier 2 Capital”, which is defined as specific subordinated debt, some hybrid capital instruments and other qualifying preferred stock and a limited amount of the loan loss allowance. Assets are adjusted under the risk-based guidelines to take into account different risk characteristics, with the categories ranging from 0% (requiring no risk-based capital) for assets such as cash and certain U.S. government and agency securities, to 100% for the bulk of assets which are typically held by a bank holding company, including certain multi-family residential and commercial real estate loans, commercial business loans and consumer loans. Residential first mortgage loans on one to four family residential real estate and certain seasoned multi-family residential real estate loans, which are not 90 days or more past due or nonperforming and which have been made in accordance with prudent underwriting standards, are assigned a 50% level in the risk-weighting system, as are certain privately issued mortgage backed securities representing indirect ownership of such loans.

In addition to the risk-based capital requirements, the Federal Reserve has established a minimum 4.0% Leverage Capital Ratio (Tier 1 Capital to total adjusted assets) requirement for the most highly rated banks, with an additional cushion of at least 100 to 200 basis points for all other banks, which effectively increases the minimum Leverage Capital Ratio for such other banks to a level of 4.0% to 6.0% or more. The highest rated banks are those that are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, those which are considered a strong banking organization. A bank having less than the minimum Leverage Capital Ratio requirement shall, within 60 days of the date as of which it fails to comply with such requirement, submit a reasonable plan describing the means and timing by which a bank shall achieve its minimum Leverage Capital Ratio requirement. A bank that fails to file such plan is deemed to be operating in an unsafe and unsound manner, and could subject that bank to a cease and desist order. Any insured depository institution with a Leverage Capital Ratio that is less than 2.0% is deemed to be operating in an unsafe or unsound condition pursuant to Section 8(a) of the FDIA and is subject to potential termination of deposit insurance. However, such an institution will not be subject to an enforcement proceeding solely on account of its capital ratios, provided it has entered into and is in compliance with a written agreement to increase its Leverage Capital Ratio and to take such other action as may be necessary for the institution to be operated in a safe and sound manner. The capital regulations also provide, among other things, for the issuance of a capital directive, which is a final order issued to a bank that fails to maintain minimum capital or to restore its capital to the minimum capital requirement within a specified time period. Such directive is enforceable in the same manner as a final cease and desist order.

Under these regulations, a state-chartered commercial bank will be:

- “well capitalized” if it has a Total Risk-Based Capital ratio of 10% or greater, a Tier 1 Risk-Based Capital ratio of 6% or greater, a Tier 1 leverage ratio of 5% or greater, and is not subject to any written capital order or directive;

- “adequately capitalized” if it has a Total Risk-Based Capital ratio of 8% or greater, a Tier 1 Risk-Based Capital ratio of 4% or greater, and a Tier 1 leverage ratio of 4% or greater (3% in certain circumstances) and does not meet the definition of “well capitalized;”
- “undercapitalized” if it has a Total Risk-Based Capital ratio of less than 8%, a Tier 1 Risk-Based Capital ratio of less than 4% or a Tier 1 leverage ratio of less than 4% (3% in certain circumstances).
- “significantly undercapitalized” if it has a Total Risk-Based Capital ratio of less than 6%, a Tier 1 Risk-Based Capital ratio of less than 3%, or a Tier 1 leverage ratio of less than 3%; or
- “critically undercapitalized” if it has a ratio of tangible equity to total assets that is equal to or less than 2%.

The risk-based capital standards of the Federal Reserve explicitly identify concentrations of credit risk and the risk arising from non-traditional activities, as well as an institution’s ability to manage these risks, as important factors to be taken into account by the agency in assessing an institution’s overall capital adequacy. The capital guidelines also provide that an institution’s exposure to a decline in the economic value of its capital due to changes in interest rates be considered by the agency as a factor in evaluating a banking organization’s capital adequacy.

Prompt Corrective Action. Immediately upon becoming undercapitalized, an institution shall become subject to the provisions of Section 38 of the FDIA, which: (a) restrict payment of capital distributions and management fees; (b) require that the appropriate federal banking agency monitor the condition of the institution and its efforts to restore its capital; (c) require submission of a capital restoration plan; (d) restrict the growth of the institution’s assets; and (e) require prior approval of certain expansion proposals. The appropriate federal banking agency for an undercapitalized institution also may take any number of discretionary supervisory actions if the agency determines that any of these actions is necessary to resolve the problems of the institution at the least possible long term cost to the deposit insurance fund, subject in certain cases to specified procedures. These discretionary supervisory actions include: (a) requiring the institution to raise additional capital; (b) restricting transactions with affiliates; (c) requiring divestiture of the institution or the sale of the institution to a willing purchaser; and (d) any other supervisory action that the agency deems appropriate. These and additional mandatory and permissive supervisory actions may be taken with respect to significantly undercapitalized and critically undercapitalized institutions.

Gramm-Leach-Bliley Act. The Gramm-Leach-Bliley Act (the “Act”) implemented major changes to the statutory framework for providing banking and other financial services in the United States. The Act, among other things, eliminated many of the restrictions on affiliations among banks and securities firms, insurance firms and other financial service providers. A bank holding company that qualifies as a financial holding company will be permitted to engage in activities that are financial in nature or incident or complimentary to financial activities. The activities that the Act expressly lists as financial in nature include insurance activities, providing financial and investment advisory services, underwriting services and limited merchant banking activities.

To become eligible for these expanded activities, a bank holding company must qualify as a financial holding company. To qualify as a financial holding company, each insured depository institution controlled by the bank holding company must be well-capitalized, well-managed and have at least a satisfactory rating under the Community Reinvestment Act. In addition, the bank holding

company must file with the Federal Reserve a declaration of its intention to become a financial holding company. The Bank presently has no plans to become a financial holding company.

Although the Act is considered one of the most significant banking laws since Depression-era statutes were enacted, because of its small size and recent organization, the Bank does not expect the Act to materially affect its products, services or other business activities. The Bank does not believe that the Act will have a material adverse impact on its operations. To the extent that it allows banks, securities firms and insurance firms to affiliate, the financial services industry may experience further consolidation. The Act may have the result of increasing competition that the Bank faces from larger institutions and other companies offering financial products and services, many of which may have substantially greater financial resources.

Payment of Cash Dividends. The Bank is subject to laws and regulations that limit the amount of dividends that it can pay. The amount of dividends that may be paid depends upon its earnings and capital position and is limited by federal and state law, regulations and policies. As a bank that is a member of the Federal Reserve System, the Bank must obtain prior written approval for any dividend if the total of all dividends declared in any calendar year would exceed the total of its net profits for that year combined with its retained net profits for the preceding two years. In addition, the Bank may not pay a dividend in an amount greater than its undivided profits then on hand after deducting its losses and bad debts. For this purpose, bad debts are generally defined to include the principal amount of loans which are in arrears with respect to interest by six months or more unless such loans are fully secured and in the process of collection. Moreover, for purposes of this limitation, the Bank is not permitted to add the balance of its allowance for loan losses account to its undivided profits then on hand, however, it may net the sum of its bad debts as so defined against the balance of its allowance for loan losses account and deduct from undivided profits only bad debts so defined in excess of that account. In addition, the Federal Reserve is authorized to determine under certain circumstances relating to the financial condition of a bank that the payment of dividends would be an unsafe and unsound practice and to prohibit payment thereof. The payment of dividends that deplete a bank's capital base could be deemed to constitute such an unsafe and unsound banking practice. The Federal Reserve has indicated that banking organizations generally pay dividends only out of current operating earnings.

In addition, under Virginia law, no dividend may be declared or paid out of the Virginia charter bank's paid-in capital. The Bank may be prohibited under Virginia law from the payment of dividends if the Virginia Bureau of Financial Institutions determines that a limitation of dividends is in the public interest and is necessary to ensure the Bank's financial soundness, and may also permit the payment of dividends not otherwise allowed by Virginia law.

Monetary Policy. Banking is a business which depends on interest rate differentials. In general, the differences between the interest paid by a bank on its deposits and its other borrowings and the interest received by a bank on loans extended to its customers and securities held in its investment portfolio constitute the major portion of the Bank's earnings. Thus, the Bank's earnings and growth will be subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve, which regulates the supply of money through various means including open market dealings in United States government securities. These dealings include the purchase and sale of securities to expand or contract the general liquidity in the financial system. Additionally, the Board of Governors of the Federal Reserve establishes a target Federal Fund Rate and the Discount Rate. The actions taken by the Federal Reserve System will dictate the general condition of interest rates in the market place.

The Bank's earnings are a function of differentials between interest rates. Depending on the organization's Asset / Liability strategy, actions taken by the Federal Reserve may have a positive or

negative effect on the profitability of the organization. The Bank cannot predict the actions of the Federal Reserve nor can it guarantee that its Asset / Liability strategy is consistent with action taken by the Federal Reserve.

Community Reinvestment Act. The Community Reinvestment Act of 1977 requires that federal banking regulators evaluate the record of the financial institutions in meeting the credit needs of their local communities, including low and moderate income neighborhoods, consistent with the safe and sound operation of those institutions. These factors are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. To the best knowledge of the Bank, it is meeting its obligations under this act.

Branching and Interstate Banking. The federal banking agencies are authorized to approve interstate bank merger transactions without regard to whether such transaction is prohibited by the law of any state, unless the home state of one of the banks has opted out of the interstate bank merger provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (the Riegle-Neal Act) by adopting a law after the date of enactment of the Riegle-Neal Act and prior to June 1, 1997, which applies equally to all out-of-state banks and expressly prohibits merger transactions involving out-of-state banks. Interstate acquisitions of branches are permitted only if the law of the state in which the branch is located permits such acquisitions. Such interstate bank mergers and branch acquisitions are also subject to the nationwide and statewide insured deposit concentration limitations described in the Riegle-Neal Act.

The Riegle-Neal Act authorizes the federal banking agencies to approve interstate branching de novo by national and state banks in states which specifically allow for such branching. Virginia has enacted laws which permit interstate acquisitions of banks and bank branches and permit out-of-state banks to establish de novo branches.

Regulatory Enforcement Authority. Federal banking law grants substantial enforcement powers to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

Transactions with Affiliates. Transactions between banks and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a bank is any bank or entity that controls, is controlled by or is under common control with such bank. Generally, Section 23A (a) limits the extent to which a bank or its subsidiaries may engage in “covered transactions” with any one affiliate to an amount equal to 10% of such institution’s capital stock and surplus, and maintain an aggregate limit on all such transactions with affiliates to an amount equal to 20% of such capital stock and surplus, and (b) requires that all such transactions be on terms substantially the same, or at least as favorable, to the bank as those provided to a non-affiliate. The term “covered transaction” includes the making of loans, purchase of assets, issuance of a guarantee and similar other types of transactions. Section 23B applies to “covered transaction” as well as sales of assets and payments of money to an affiliate. These transactions must also be conducted on terms substantially the same, or at least as favorable, to the bank as those provided to non-affiliates.

Loans to Insiders. The Federal Reserve Act and related regulations impose specific restrictions on loans to directors, executive officers and principal shareholder of banks. Under Section 22(h) of the Federal Reserve Act, any loan to a director, an executive officer or to a principal shareholder of a bank, or to entities controlled by any of the foregoing, may not exceed, together with all outstanding loans to such

persons or entities controlled by such person, the bank's loan to one borrower limit. Loans in the aggregate to insiders of the related interest as a class may not exceed two times the bank's unimpaired capital and unimpaired surplus until the bank's total assets equal or exceed \$100 million, at which time the aggregate is limited to the bank's unimpaired capital and unimpaired surplus. Section 22(h) also prohibits loans above amounts prescribed by the appropriate federal banking agency to directors, executive officers, and principal shareholders of a bank or bank holding company, and to entities controlled by such persons, unless such loans are approved in advance by a majority of the Board of Directors of the bank with any "interested" director not participating in the voting. The Bank's loan amount, which includes all other outstanding loans to such person, as to which such prior board of director approval is required, must be the greater of \$25,000 or 5% of capital and surplus (up to \$500,000). Section 22(h) requires that loans to directors, executive officers and principal shareholders be made in terms and underwriting standards substantially the same as offered in comparable transactions to other persons.

Other Regulation. The Bank is subject to a variety of other regulations. State and federal laws restrict interest rates on loans, potentially affecting the Bank's income. The Truth in Lending Act and the Home Mortgage Disclosure Act impose information requirements on the Bank in making loans. The Equal Credit Opportunity Act prohibits discrimination in lending on the basis of race, creed, or other prohibited factors. The Fair Credit Reporting Act governs the use and release of information to credit reporting agencies. The Truth in Savings Act requires disclosure of yields and costs of deposits and deposit accounts. Other acts govern confidentiality of consumer financial records, automatic deposits and withdrawals, check settlement, endorsement and presentment, and reporting of cash transactions as required by the Internal Revenue Service.

USA Patriot Act of 2001. In October 2001, the USA Patriot Act of 2001 was enacted in response to the terrorist attacks in New York, Pennsylvania and Washington, D.C. which occurred on September 11, 2001. The Patriot Act is intended to strengthen the ability of U.S. law enforcement agencies and the intelligence communities to work cohesively to combat terrorism on a variety of fronts. The potential impact of the Patriot Act on financial institutions of all kinds is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

Future Regulatory Uncertainty. Because federal regulation of financial institutions changes regularly and is the subject of constant legislative debate, the Bank cannot forecast how federal regulation of financial institutions may change in the future and impact its operations. Although Congress in recent years has sought to reduce the regulatory burden on financial institutions with respect to the approval of specific transactions, the Bank fully expects that the financial institution industry will remain heavily regulated in the near future and that additional laws or regulations may be adopted further regulating specific banking practices.

Dependence on Key Personnel

The Bank's growth and development to date have been largely dependent upon the services of William J. Farinholt, President and Chief Executive Officer, and Kenneth E. Smith, Executive Vice President and Chief Financial Officer. The loss of Mr. Farinholt's or Mr. Smith's services for any reason could have a material adverse effect on the Bank. In May 2004, the Bank purchased \$1,000,000 key man life insurance on each of these individuals.

Control by Certain Shareholders

Walter B. Hurley, Jr., a director of the Bank, is directly or indirectly beneficial owner of more than 5.0% of the outstanding common stock of the Bank. Mr. Hurley's ownership reached a level of 7.23% on August 8, 2007. The Bank is not aware of any other shareholder who owns more than 5.0% of the outstanding common stock of the Bank. As a group, the Board of Directors and the Bank's Executive Officers control 17.7% of the outstanding common stock of the Bank. Accordingly, such persons, if they were to act in concert, would not have majority control of the Bank, would not have the ability to approve certain fundamental corporate transactions or the election of the Board of Directors.

Item 2. Description of Property

The Bank's Main Office and operating headquarters are located at 6720 Sutton Road in Gloucester.

The Bank's branch office is located at 1553 George Washington Memorial Highway (U.S. Route 17) in Gloucester Point.

The Main Office and the branch office properties are owned by the Bank.

The Bank's properties are in good operating condition and are adequate for the Bank's present and anticipated future needs.

Item 3. Legal Proceedings

The Bank is not a party to any pending legal proceeding outside the ordinary course of its business that could have a material impact on financial statements.

Item 4. Submission of Matters to a Vote of Security Holders

None.

PART II

Item 5. Market for Common Equity and Related Stockholder Matters

The Bank's common stock is listed on the Over the Counter Bulletin Board (www.otcbb.com) under the symbol of CNVB. The initial issue price of the January 27, 2003 stock offering of the Bank's common stock was \$20.00 per share. The following table sets forth the high and low prices for transactions in the Bank's common stock known to the Bank in 2007 and 2006.

	High	Low
<u>2007</u>		
Fourth Quarter	\$25.00	\$21.00
Third Quarter	\$28.50	\$22.10
Second Quarter	\$29.00	\$28.50
First Quarter	\$30.00	\$27.00

<u>2006</u>		
Fourth Quarter	\$28.50	\$27.00
Third Quarter	\$28.50	\$26.25
Second Quarter	\$28.00	\$25.00
First Quarter	\$25.00	\$23.50

The Bank has not paid any dividends on its Common Stock. The Bank intends to retain all of its earnings to finance its operations and does not anticipate paying cash dividends for the foreseeable future. Any decision made by the Board of Directors to declare dividends in the future will depend on the Bank's future earnings, capital requirements, financial condition, government regulations and other factors deemed relevant by the Board, as previously discussed in Item 1, Supervision and Regulations, Payment of Cash Dividends.

As of March 28, 2008, the Bank had approximately 846 shareholders of record.

The Bank did not repurchase any shares of its common stock during the fourth quarter of 2007.

Item 6. Management's Discussion and Analysis or Plan of Operation

The following discussion should be read in conjunction with the financial statements, accompanying notes and selected financial data appearing elsewhere in this Annual Report on Form 10-KSB and may contain certain forward-looking statements that are based on current management expectations. Generally, verbs in the future tense and the words, "believe," "expect," "anticipate," "intends," "opinion," "potential" and similar expressions identify forward-looking statements. Examples of this forward-looking information can be found in, but are not limited to, the expected effects of accounting pronouncements and government regulation applicable to the Bank's operations, the discussion of allowance for loan losses, litigation and any quantitative and qualitative disclosure about market and interest rate risk. The actual results of the Bank could differ materially from those management expectations. The forward-looking statements contained herein speak only as of the date of this Annual Report on Form 10-KSB, and, except as may be required by applicable law and regulation, the Bank does not undertake, and specifically disclaims any obligation, to publicly update or revise such statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

Overview

The Bank is headquartered in Gloucester, Virginia and conducts its primary operations through the Bank. The Bank is a community bank principally serving the Virginia county of Gloucester, but also providing banking services in the overall market known as the Middle Peninsula, as well as the Peninsula. The Bank also has an investment division operating under the name of Colonial Virginia Investment Services. The Bank began offering a full suite of mortgage services October 1, 2006, through Colonial Virginia Mortgage, LLC ("CVM"). CVM is owned jointly with Johnson Mortgage Company, LLC, of Newport News, Virginia, and each owner possesses 50% ownership. CVM was capitalized with \$250,000, with each owner contributing \$125,000. CVM makes and sells whole loans, and it is believed to be a good complement to the Bank's overall lending program by expanding the suite of loan products to include fixed rate permanent mortgage loans. A significant enhancement to the Bank's construction lending practices will be the ability to offer single closing construction to permanent mortgage lending. This feature is attractive among customers for convenience and reduced overall costs.

The Bank's results of operations are primarily dependent on net interest income, which is the difference between the income earned on loans and the investment portfolio and the cost of funds,

consisting of the interest paid on deposits and borrowings. Results of operations are also affected by the allowance for loan losses and non-interest income from such activities as investment and mortgage services and other customer service fees. Non-interest expense principally consists of salaries and benefits, occupancy and equipment expenses, business development costs, professional fees, data processing expense and other expenses.

Critical Accounting Policies

General

The financial condition and results of operations presented in the Financial Statements, the accompanying Notes to Financial Statements and this section are, to a large degree, dependent upon the accounting policies of the Bank. The selection and application of these accounting policies involve judgments, estimates, and uncertainties that are susceptible to change.

Presented below is discussion of those accounting policies that management believes are the most important (“Critical Accounting Policies”) to the portrayal and understanding of the Bank’s financial condition and results of operations. The Critical Accounting Policies require management’s most difficult, subjective and complex judgments about matters that are inherently uncertain. In the event that different assumptions or conditions were to prevail, and depending upon the severity of such changes, the possibility of a materially different financial condition or results of operations is a reasonable likelihood.

Allowance for Loan and Lease Losses

The Bank monitors and maintains an allowance for loan and lease losses (“ALLL”) to absorb an estimate of probable losses inherent in the loan portfolio. The Bank maintains policies and procedures that address the systems of controls over the following areas of maintenance of the allowance: the systematic methodology used to determine the appropriate level of the allowance to provide assurance that the systems are maintained in accordance with accounting principles generally accepted in the United States of America; the accounting policies for loan charge-offs and recoveries; the assessment and measurement of impairment in the loan portfolio; and the loan grading system. The Bank uses an internal risk rating system and assigns a numeric rating to each loan based on multiple criteria, including but not limited to a borrower’s credit history (evidenced by credit bureau reporting), collateral and its supporting value, type of work or industry in which the borrower is involved, and any noted exceptions to internal policy. Varying percentages of outstanding balances by risk rating are used in determining the adequacy of the ALLL.

The ALLL consists of two components, allocated and unallocated. The Bank evaluates various loans individually for impairment as required by Statement of Financial Accounting Standards (“SFAS”) No. 114, *Accounting by Creditors for Impairment of a Loan*, and SFAS No. 118, *Accounting by Creditors for Impairment of a Loan – Income Recognition and Disclosures*. Loans evaluated individually for impairment include non-performing loans, such as loans on non-accrual, loans past due by 90 days or more, restructured loans and other loans selected by management. The evaluations are based upon discounted expected cash flows or collateral valuations. If the evaluation shows that a loan is individually impaired, then a specific reserve is established for the amount of impairment. If a loan evaluated individually is not impaired, then the loan is assessed for impairment under SFAS No. 5, *Accounting for Contingencies* (“SFAS 5”), with a group of loans that have similar characteristics.

For loans without individual measures of impairment, the Bank makes estimates of losses for groups of loans as required by SFAS 5. Loans are grouped by similar characteristics, including the type of loan, the assigned loan grade and the general collateral type. A loss rate reflecting the expected loss

inherent in a group of loans is derived based upon estimates of default rates for a given loan grade, the predominant collateral type for the group and the terms of the loan. The resulting estimate of losses for groups of loans are adjusted for relevant environmental factors and other conditions of the portfolio of loans, including: borrower and industry concentrations; levels and trends in delinquencies, charge-offs and recoveries; changes in underwriting standards and risk selection; level of experience, ability and depth of lending management; and national and local economic conditions.

The amounts of estimated impairment for individually evaluated loans and groups of loans are added together for a total estimate of loan losses. This estimate of losses is compared to the allowance for loan losses of the Bank as of the evaluation date and, if the estimate of losses is greater than the allowance, an additional provision to the allowance would be made. If the estimate of losses is less than the allowance, the degree to which the allowance exceeds the estimate is evaluated to determine whether the allowance falls outside a range of estimates. If the estimate of losses is below the range of reasonable estimates, the allowance would be reduced by way of a credit to the provision for loan losses. The Bank recognizes the inherent imprecision in estimates of losses due to various uncertainties and variability related to the factors used, and therefore a reasonable range around the estimate of losses is derived and used to ascertain whether the allowance is too high. If different assumptions or conditions were to prevail and it is determined that the allowance is not adequate to absorb the new estimate of probable losses, an additional provision for loan losses would be made, which amount may be material to the Financial Statements.

Executive Overview

Net income of \$97,307 or \$0.16 per share assuming dilution, was recorded for the year ended December 31, 2007, compared with \$568,595, or \$0.93 per share assuming dilution, for the same period of 2006. 2007 was a year of significant expenses in five specific categories.

First, the Bank demonstrated its commitment to community service by donating approximately five (5) acres of property to the Gloucester-Mathews Humane Society to enable them to complete their capital building program, the construction of a new state-of-the-art facility. This donation resulted in a non-cash expense of \$303,000, a substantial amount in light of the Bank's current earnings level. However, the Bank takes its corporate citizenship seriously and considers it a privilege to share in this exciting chapter of the Humane Society's life.

Second, the Bank recorded a \$190,700 provision for possible loan losses (an increase of \$161,500 over 2006). The Bank has not experienced any "fallout" from the nationwide "sub-prime mortgage" dilemma. However, Management considered it prudent to bolster the Allowance for Loan and Lease Losses ("ALLL") reserve during these unpredictable economic times. The additional expense in 2007 resulted in an ALLL of 0.91% of outstanding loans compared to 0.71% at December 31, 2006. Management has continued to exercise conservative underwriting standards in its lending practices.

Third, the Bank recorded \$210,060 in pension expense under the Bank's Supplemental Executive Retirement Plan ("SERP"). This represented an increase of \$48,921 over 2006 due to an adjustment prompted by an accounting rules change associated with SFAS 158 which became effective in the fourth quarter of 2006. The accounting statement issued by the Financial Accounting Standards Board ("FASB") addressed the accounting periods in which pension expenses and corresponding accrued liabilities are recognized. The effect of this rule change will have minimal effect going forward in year over year comparisons, but did represent a material change for 2007. The total expense during the working life of the plan does not change, only the accounting periods in which they are recorded.

Fourth, the Bank experienced a \$37,370 increase in audit expense in 2007, associated primarily with expenses related to the Bank's required compliance with the provisions of the Sarbanes-Oxley Act of 2002 ("SOX"). Section 404 of SOX includes a major audit burden that had been delayed for small public companies, including the Bank, until 2007. Since this is the Bank's first year of required compliance, the 2007 expense included additional expense for the "documentation phase" that should not be as significant in 2008.

Fifth, the Bank embarked on a new marketing campaign in 2007, engaging an advertising consultant. This resulted in an increase in advertising expenses of \$52,681 (62.5%) over 2006. The focus of the campaign was increased brand and name recognition. Management considers the effort to be quite successful and will likely reduce moderately the expense going forward.

The 2007 net income figure also reflects a \$223,315 income tax credit as a result of the Bank's recognition of deferred tax assets.

Total average assets increased 23.8% from the December 31, 2006 amount of \$72.3 million to \$89.5 million at December 31, 2007. Average shareholders' equity increased 4.6% to \$11.3 million in 2007. Return on average assets and equity at December 31, 2007 were 0.11% and 0.86%, respectively.

Total assets for the Bank increased to \$95.5 million at December 31, 2007, compared to \$81.2 million at December 31, 2006, representing an increase of \$14.3 million or 17.6%. Total net loans at December 31, 2007 were \$53.7 million, an increase of \$7.6 million, or 16.5%, from the December 31, 2006 amount of \$46.1 million. The provision for loan losses in 2007 was \$190,700. The allowance for loan and lease losses was \$491,383 or 0.91% of total loans outstanding at December 31, 2007.

The investment portfolio increased 40.1% to \$29.7 million at December 31, 2007 compared to \$21.2 million at December 31, 2006. The current investment strategy is to employ excess liquidity in securities with yields that will enhance overall interest earnings without creating undue interest rate risk. The Bank continues its posture of not attempting to forecast interest rates in a vacuum. Fluctuations in the market value of the Bank's portfolio have shifted the Bank from an unrealized loss position on securities available for sale of \$69,340, net of taxes, at December 31, 2006, to an unrealized gain position of \$168,579, net of taxes, at December 31, 2007. It is important to note that changes in the market value of the Bank's bond portfolio are directly attributable to the fluctuating interest rate environment and not associated with any instances of deteriorating credit quality. The level of interest rate risk and market risk are considered manageable relative to overall balance sheet management. The Bank does not rely on funds from the bond portfolio for primary liquidity beyond the respective maturity of individual bonds.

The composition of the Bank's investment securities portfolio reflects the Bank's investment strategy of maximizing portfolio yields commensurate with risk and liquidity considerations. The primary objectives of the Bank's investment strategy are to maintain an appropriate level of liquidity and to provide a tool to assist in controlling the Bank's interest rate sensitivity position while, at the same time, producing adequate levels of interest income. The Bank's investment securities are classified into one of two categories based upon Management's intent to hold the investment securities: (i) investment securities held to maturity or; (ii) investment securities available for sale. Investment securities held in a trading account are required to be reported at fair value, with unrealized gains and losses included in earnings. Investment securities designated to be held to maturity are reported at cost, adjusted for amortization of premiums and accretion of discounts, with such amortization and accretion being determined by the interest rate method. The Bank has the ability, and it is Management's intention, to hold these securities to maturity. Management of the maturity of the portfolio is necessary to provide liquidity and control interest rate risk. Investment securities available for sale are recorded at fair value. Increases and decreases in the net unrealized gain or loss on the investment securities available for sale

portfolio are reflected as adjustments to the carrying value of the portfolio and as an adjustment, net of tax, to accumulated other comprehensive income.

Fair values of investment securities available for sale are based primarily on quoted or other independent market prices. If quoted market prices are not available, then fair values are estimated using pricing models, quoted prices of instruments with similar characteristics or discounted case flows.

Total deposits increased \$13.5 million to \$82.9 million at December 31, 2007 from \$69.4 million at December 31, 2006. Of the total deposit level, time deposits totaled \$62.8 million at December 31, 2007, an increase of \$14.4 million from \$48.4 million at December 31, 2006.

Shareholders' equity was \$11.5 million at December 31, 2007. This amount represents an increase of 4.5% from the December 31, 2006 amount of \$11.0 million. The book value per common share was \$18.86 at December 31, 2007 and \$18.15 at December 31, 2006.

Growth levels continue to be encouraging. The composition of balance sheet growth was initially more commercial than consumer in nature, which has reflected lower than expected yields in the loan portfolio. Pricing practices have continued to be more aggressive in an effort to maximize loan yields. While this aggressive lending posture is intended to enhance overall asset yield and resultant net interest income, management has maintained credit quality at the forefront of its underwriting practices. The Bank's initial investment in experienced lending personnel should aid in this effort to closely manage asset quality.

Net Interest Income

Net interest income is the Bank's primary source of earnings and represents the difference between interest and fees earned on earning assets and the interest expense paid on deposits and other interest bearing liabilities. Net interest income totaled \$3.1 million for the year ended December 31, 2007, compared to \$2.9 million for the year ended December 31, 2006. Average earning assets increased \$16.4 million from \$64.7 million for the year ended December 31, 2006 to \$81.1 million for the year ended December 31, 2007. Average deposits increased \$16.2 million from \$61.2 million for the year ended December 31, 2006 to \$77.4 million for the year ended December 31, 2007. Total interest expense was \$3.1 million for the year ended December 31, 2007, compared to \$2.1 million for the year ended December 31, 2006. The net interest margin (net interest income expressed as a percentage of average earning assets) ("NIM"), on a tax equivalent basis, was 3.81% for the year ended December 31, 2007 compared to 4.42% for the year ended December 31, 2006.

The cause of the most recent compression of the NIM is multi-fold. First, the Federal Open Market Committee ("FOMC") ceased its practice of increasing rates at each of its meetings during the third quarter 2006. Since that time, the Bank's "Prime Rate" related loans remained stable while certificates of deposit ("CDs") used to fund them gradually increased as they renewed from origination rates established in a lower rate environment. This caused compression of the Bank's net interest margin discussed elsewhere in this report. Additionally, during the second half of 2007, the FOMC began a strategic initiative of reducing rates. This immediately reduced the yield of approximately \$29.0 million in variable rate loans, while a significant volume of CDs continued to reprice upwards due to renewal rates that were still in excess of origination rates, despite the declining rate environment. In effect, the cost of funds was increasing, despite decreasing rates from 2006 levels, while the yield on earning assets was decreasing. The Bank attempted, during the second half of 2007, to purchase investments with maturities and/or call features that protected against falling interest rates. Mitigating this compression of the NIM is the repricing opportunities of three year adjustable rate mortgages ("ARMs") originated by the

Bank in 2004 which will reflect increasing loan yields in the near future, even if the FOMC holds rates level.

The Bank's absolute volume of earning assets is below its desired level for long-term balance sheet management. It is noted that by opening the Bank with two offices at the same time and completing the permanent buildings for both locations in 2005, substantial amounts of investment funds were directed to fixed assets (non-earning assets). These offices are spacious, modern facilities and are considered to position the Bank well for expanded operations well into the future. Management continues its focus on increasing earnings assets as a percentage of total assets.

The Bank utilizes asset liability management modeling software to assist in the identification and management of interest rate risk. This software provides tools for identifying repricing intervals, maturities, and cash flows of interest earning assets and interest bearing liabilities. In addition, income simulations are performed applying interest rate shocks to interest sensitive assets and liabilities. Modeling techniques are designed to enable the Bank to minimize significant swings or variations in net interest income during periods of substantial fluctuations in market rates. The Bank does not specifically attempt to predict interest rate movements. It is, however, important to point out that the Bank is not immune to both market rates in general and the shape of the market's yield curve or the slope of the graph that plots interest rates over time. The effect and impact of the yield curve on maturing assets and liabilities can be profound when the yield curve is "inverted" which means that interest rates which normally increase over extended time horizons instead are higher in the shorter term maturities and lower in longer term maturities. The Bank's model is able to forecast repricing symmetry or asymmetry of administered deposits, such as money market, NOW and savings. The Bank's current repricing of these deposits is considered asymmetrical representing a modest deposit pricing disadvantage. This is because, given a hypothetical 100 basis point increase in market rates, the Bank might require a corresponding 50 to 75 basis point increase in rates paid for these deposit types, while given a similar hypothetical 100 basis point decrease in market rates, the Bank would more likely only be able to reduce the rates paid on these deposit types by 25 to 50 basis points. Therefore, a decrease in rates would result in compression of the NIM and decrease net interest income.

The Bank's balance sheet structure has evolved into a moderately asset sensitive condition. This condition means that assets may reprice more quickly than liabilities and, in a rising rate environment, interest income would increase more quickly than interest expense. Conversely, when interest rates fall, interest income would decrease more quickly than interest expense. Through the use of the modeling techniques mentioned above, Management is closely monitoring the volumes of interest bearing liabilities that are scheduled for repricing within the next 90 day, 180 day and one year intervals. The Bank markets 10 and 13 month CDs to manage the interest rate risk associated with being asset sensitive, should the FOMC actually decrease short-term rates within the next twelve months. The Bank also continues its practice of including interest rate floors in new variable rate loan instruments. This measure is designed to guard against exposure to reduced interest income associated with possible falling rates in the future.

Non-interest Income

Non-interest income totaled \$274,196 for the year ended December 31, 2007, compared to \$209,110 for the year ended December 31, 2006. The primary components of non-interest income include service charges on deposit accounts, ATM and debit card transaction fees, commissions on credit life insurance, checkbook sales and title insurance.

Service charges on deposit accounts totaled \$87,475 for the year ended December 31, 2007, compared to \$67,229 for the year ended December 31, 2006. The increase during 2007 is attributable to the continuing growth in the number of new accounts and an expanding volume of network interchange

fees resulting from the growing use of debit cards among the Bank's customers. The Bank had no specific fee rate increases.

The Bank began offering investment services during the fourth quarter of 2005 through a new division of the Bank, Colonial Virginia Investment Services. The program is affiliated with Community Bankers Securities, Richmond, Virginia. Initial fixed costs such as personnel and overhead expense have resulted in operating losses and will continue to until such time as critical mass of transactional operations passes a breakeven point. The Bank employed an individual in September 2005 who is a native of Gloucester County and has worked in and around the Bank's general market for several years. Thus, he is expected to build an attractive portfolio of customers in the near future. Initial response has met management's expectations, and these operations are projected to enhance overall non-interest income, as well as expand customer relationships. In 2007, net revenue from investment sales activities totaled \$29,398.

The Bank's mortgage subsidiary, CVM, is projected initially to experience minimal net operating losses due to start-up costs and personnel overhead until mortgage originations reach an average critical mass level of approximately \$10 million annually. CVM's projected income is expected to enhance the Bank's non-interest income. In addition, the Bank will provide a portion of CVM's warehouse line of credit. This line of credit will enable CVM to fund its mortgages at closing until they are sold to secondary market investors, a period which is typically seven to twenty-five days. This practice is expected to enhance the Bank's interest income. Income from the mortgage division totaled \$15,337 in 2007.

Non-interest Expense

Non-interest expense includes employee-related costs, occupancy and equipment expense and other overhead. Total non-interest expense equaled \$3.3 million in 2007, compared to \$2.7 million in 2006.

Salaries and employee benefits totaled \$1.6 million in the year ended December 31, 2007, compared to \$1.5 million for the year ended December 31, 2006. The Bank hired highly experienced staff to begin operations. This strategy created substantial non-interest expense in the short-term, but is projected to build customer relationships more quickly and enhance long-term earnings performance for the Bank.

Strategic competitive decisions at the Bank's inception were made regarding product offerings, such as internet and telephone banking, ATM and debit cards, check imaging and optical file storage, all of which resulted in substantial initial investment in technology. Along with the decision discussed above regarding personnel, these technology decisions are expected to produce long-term efficiencies and competitive necessities. However, such initial financial investments require more critical mass of customer accounts when such a heavy reliance is placed on net interest income for overall profitability.

The Bank completed the permanent building for both of its offices during 2005. The Gloucester Point facility was occupied at the end of the first quarter, while the Main Office Courthouse location was occupied in October 2005. Occupancy of the permanent building has enhanced overall convenience and efficiency. Modest increases in associated overhead expenses are projected to be absorbed through expanded gross revenues in the near future. As discussed above in net interest income, the significant investment in technology, plant and equipment (non-earnings assets) reduced the volume of funds which could be invested in earnings assets.

As discussed further below in Item 8A(T), Controls and Procedures, the Bank became subject to full compliance in 2007 to the Sarbanes-Oxley Act of 2002 (“SOX”). Specifically, Section 404 of SOX requires a much expanded validation of the Bank’s systems of internal controls over financial reporting compared to the current environment in which the Bank operates. In 2007, the Bank expensed \$28,324 for audit services directly associated with SOX compliance.

Non-GAAP Financial Measures

A measure of the extent to which the Bank’s revenues are absorbed by non-interest expenses is expressed as the efficiency ratio. The efficiency ratio is calculated by dividing non-interest expenses by the sum of total non-interest income and net interest income for the period. This is a non-GAAP financial measure, which we believe provides important information about our operational efficiency. Comparison of our efficiency ratio with those of other companies may not be possible because other companies may calculate the ratio differently. As a de novo bank, it is expected that this ratio will be extremely high in the early period of operation due to the myriad of startup expenses. As the Bank matures, an efficiency ratio of 60 to 65% is targeted. At December 31, 2007, the Bank’s efficiency ratio was 98.13% compared to 87.24% at December 31, 2006.

Still another indicator of the appropriate use of personnel is the measurement of assets expressed as millions of dollars of assets per employee. This measurement was \$3.5 million per employee at December 31, 2007, compared to \$3.0 million at December 31, 2006. Unfortunately, due to the demands of increased levels of internal control associated with SOX (discussed elsewhere in this report), the Bank may have to increase staff in operational areas in the future. Management, up to this point, has attempted to offset the need for staff through the use of technology.

Allowance for Loan and Lease Losses

The allowance for loan and lease losses (“ALLL”) at December 31, 2007 was \$491,383, compared to \$329,462 at December 31, 2006. The allowance for loan losses was 0.91% of total loans outstanding at December 31, 2007, compared to 0.71% at December 31, 2006. The provision for loan losses was \$190,700 for the year ended December 31, 2007, compared to \$29,200 for the year ended December 31, 2006. The provision for loan and lease losses represents Management’s judgment of the current period cost of credit risk inherent in the Bank’s loan portfolio. Specifically, the provision represents the amount charged against current period earnings to achieve an allowance for potential losses that, in Management’s judgment, is adequate to absorb probable losses inherent in the Bank’s loan portfolio. Accordingly, the provision expense will vary from period to period based on Management’s ongoing assessment of the adequacy of the ALLL. In 2007, Management became more aggressive in its ALLL adequacy methodology regarding risk assessment of unsecured credit as well as general economic conditions. This resulted in a demand for increased provision for loan loss expense, although the level of imbedded risk in the portfolio and more specifically the level of impaired loans is considered relatively stable. The Bank has not been affected by the nationwide “sub-prime” mortgage crisis since it is not active in sub-prime lending. Management believes that the ALLL is adequate to cover credit losses inherent in the loan portfolio at December 31, 2007. Loans past due 90 days and over totaled \$8,864 at December 31, 2007, compared to \$0 at December 31, 2006. Repossessions totaled \$55,000 at December 31, 2007, compared to \$0 at December 31, 2006. Despite these somewhat negative trends, Management does not anticipate material losses in either of these categories.

Management uses an internal credit risk rating system which includes six “pass” grades, as well as four adverse grades. All existing loans have been assigned an individual risk rating. Management not only incorporates these ratings into its methodology for evaluating the adequacy of the ALLL, but also

into pricing strategies. This methodology also reflects the provision for loan loss expense to accommodate only the risks associated with this evaluation exercise.

Capital Resources

Shareholders' equity at December 31, 2007 and December 31, 2006 was \$11.5 million and \$11.0 million, respectively. The 2007 amount includes "accumulated other comprehensive income" of \$49,123. This amount is comprised of a credit amount of \$168,579 of unrealized gains on available for sale securities, net of tax, and \$119,456 representing the unamortized debit balance on a one-time lump sum adjustment to accrued pension liability pursuant to SFAS No. 158, net of tax (discussed elsewhere in this report). Total common shares outstanding at December 31, 2007 were 610,175.

At December 31, 2007, the Bank's tier 1 and total risk-based capital ratios were 17.5% and 18.3%, respectively, compared to 20.2% and 20.8% at December 31, 2006. The Bank's leverage ratio was 12.1% at December 31, 2007, compared to 14.1% at December 31, 2006. The Bank raised in excess of \$12.0 million in initial capital prior to opening, resulting in skewed capital ratios, compared to industry averages, until such time as the Bank's asset base grows to fully leverage initial capital. The Bank's capital structure places it above the regulatory guidelines, which affords the Bank the opportunity to take advantage of business opportunities while ensuring that it has the resources to protect against risk inherent in its business. This level of capital also provides sufficient resources during the business development stage.

Liquidity and Interest Rate Sensitivity

The primary functions of asset and liability management are to (1) assure adequate liquidity; (2) maintain an appropriate balance between interest-sensitive assets and interest-sensitive liabilities; (3) maximize the profit of the Bank; and (4) reduce risks to the Bank's capital. Liquidity management involves the ability to meet day-to-day cash flow requirements of the Bank's customers, whether they are depositors wishing to withdraw funds or borrowers requiring funds to meet their credit needs. Without proper liquidity management, the Bank would not be able to perform the primary function of a financial intermediary and would, therefore, not be able to meet the needs of the communities it serves. Management believes that the Bank maintains overall liquidity sufficient to satisfy its depositors' requirements and to meet its customers' credit needs. Interest rate risk management focuses on the maturity structure of assets and liabilities and their repricing characteristics during changes in market interest rates. Effective interest rate sensitivity management ensures that both assets and liabilities respond to changes in interest rates within an acceptable time frame, thereby minimizing the effect of such interest rate movements on the net interest margin.

The asset portion of the balance sheet provides liquidity primarily from two sources. These sources are principal payments and maturities and sales relating to loans, and maturities and principal payments from the investment portfolio. Other short-term investments such as federal funds sold are additional sources of liquidity. Loans, maturing or repricing in one year or less, totaled \$38.5 million at December 31, 2007. Investment securities that are forecast to mature or reprice over the next twelve months total \$10.1 million, or 34.2% of the investment portfolio as of December 31, 2007.

Although the majority of the securities portfolio has legal final maturities longer than 10 years, the entire portfolio consists of securities that are readily marketable and easily convertible into cash. As of December 31, 2007, due to call options, scheduled principal payments, and projected pre-payments, the bond portfolio had an expected average maturity of approximately 2.7 years, with approximately 83% expected to be repaid within 5 years. However, Management does not rely solely upon the investment portfolio to generate cash flows to fund loans, capital expenditures, dividends, debt repayment, and other

cash requirements. Instead, these activities are funded by cash flows from operating activities and increases in deposits and short-term borrowings.

The liability portion of the balance sheet provides liquidity through interest bearing and non-interest bearing deposit accounts.

The Bank also maintains additional sources of liquidity through federal funds guidance lines with correspondent banks, which totaled \$7.1 million at December 31, 2007. The Bank terminated its previous arrangement with QwickRate, a nationally organized program whereby financial institutions may publish interest rates for CDs of various maturities and attract deposits from other investors (predominantly credit unions). To replace this potential funding source, the Bank joined the Federal Home Loan Bank of Atlanta (“FHLB”) in the fourth quarter of 2007. The Bank will have various borrowing options through the FHLB, although such borrowings will require collateralization by means of pledging investment securities or certain loans secured by real estate, which is expected to be complete during the first quarter of 2008. The Bank will have borrowing capacity of approximately \$9.5 million with the FHLB.

At December 31, 2007, cash, interest bearing deposits with financial institutions, federal funds sold and securities available for sale were 35.4% of total deposits and liabilities. Management, under a Board approved Liquidity and Funding Policy, routinely monitors the Bank’s liquidity position using various schedules and reports. A “Short-term Funds Availability Ratio” computes short-term assets (cash and due from banks, overnight funds and other cash equivalents, market value of available for sale securities, and unused lines of credit). The policy requires that this ratio be equal to or greater than 15% of total assets. At December 31, 2007, this ratio was 40.4%. Liability funding sources are also monitored. Demand and savings deposits, interest bearing and non-interest bearing, and time deposits under \$100,000 are monitored with a targeted level of 60% or greater as a percentage of total assets. At December 31, 2007, this percentage was 62.0%.

In the fourth quarter 2007, the Bank began participating in a CD program with the Treasurer of Virginia, administered through Community Bankers Bank of Virginia (“CBB”). Due to the fact that CBB manages this program for the State of Virginia, these deposits are considered “brokered” deposits. As of December 31, 2007, the Bank held \$1.0 million of these CD funds. The Bank holds no other brokered funds.

Off-Balance Sheet Arrangements

The Bank 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 loan commitments, standby letters of credit and documentary letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the financial statements.

The Bank’s exposure to credit loss in the event of non-performance by the other party of these loan commitments and standby letters of credit is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Since many of the loan commitments and letters of credit may expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. The Bank evaluates each customer’s credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management’s credit evaluation of

the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, owner-occupied real estate and income-producing commercial properties.

The Bank maintains funds on deposit at correspondent banks which at times exceed the federally insured limits. Management of the Bank monitors the balance in these accounts and periodically assesses the financial condition of correspondent banks.

Future Events and Other Matters

The Bank is making plans to begin offering remote merchant deposit capture for its commercial customers in 2008. This product will enhance the Bank's ability to attract valuable new commercial deposits from areas where the Bank has no physical presence by allowing "non-cash" deposits to be transmitted electronically, eliminating the need for the commercial customer to come to the Bank. Because other competitors have gradually begun to offer similar products, the Bank also believes that such a step is needed to retain existing valuable commercial customers.

Caution About Forward Looking Statements

Certain information contained in this discussion may include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are generally identified by phrases such as "the Bank expects," "the Bank believes" or words of similar import.

Such forward-looking statements involve known and unknown risks including, but not limited to, the following factors:

- risks inherent in making loans such as repayment risks and fluctuating collateral values;
- the successful management of interest rate risk;
- the ability to continue to attract low cost core deposits to fund asset growth;
- changes in general economic and business conditions in the Bank's market area;
- reliance on the Bank's management team, including its ability to attract and retain key personnel;
- competition with other banks and financial institutions, and companies outside of the banking industry, including those companies that have substantially greater access to capital and other resources;
- managing the cost and implementation on new technology required to compete and to meet increasing regulatory requirements
- the ability to successfully manage the Bank's growth or implement its growth strategies if it is unable to identify attractive markets, locations or opportunities to expand in the future;
- changing trends in customer profiles and behavior;
- problems with technology utilized by the Bank;
- changes in banking and other laws and regulations applicable to the Bank;
- demand, development and acceptance of new products and services; and
- maintaining capital levels adequate to support the Bank's growth.

Although the Bank believes that its expectations with respect to the forward-looking statements are based upon reliable assumptions within the bounds of its knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Bank will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements.

COLONIAL VIRGINIA BANK

Gloucester, Virginia

FINANCIAL REPORT

DECEMBER 31, 2007

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To the Board of Directors
Colonial Virginia Bank
Gloucester, Virginia

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have audited the balance sheets of Colonial Virginia Bank as of December 31, 2007 and 2006, and the related statements of income, changes in shareholders' equity and cash flows for each of the two-year period ended December 31, 2007. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Colonial Virginia Bank as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the two-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

We were not engaged to examine management's assertion about the effectiveness of Colonial Virginia Bank's internal control over financial reporting as of December 31, 2007 included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting and, accordingly, we do not express an opinion thereon.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 26, 2008

COLONIAL VIRGINIA BANK
Balance Sheets
December 31, 2007 and 2006

Assets	2007	2006
Cash and due from banks	\$ 2,174,513	\$ 2,012,673
Federal funds sold	2,756,458	5,095,375
Securities available for sale, at fair market value	26,533,407	17,479,174
Securities held to maturity (fair market value of \$3,227,514 in 2007 and \$3,777,160 in 2006)	3,203,906	3,764,643
Loans, net of allowance for loan losses of \$491,383 in 2007 and \$329,462 in 2006	53,658,504	46,125,422
Bank premises and equipment, net	3,753,744	4,258,753
Bank owned life insurance	2,089,533	1,549,590
Other assets	<u>1,290,036</u>	<u>901,896</u>
 Total assets	 <u>\$ 95,460,101</u>	 <u>\$ 81,187,526</u>
 Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Noninterest-bearing demand deposits	\$ 6,779,679	\$ 6,536,531
Savings and interest-bearing demand deposits	13,376,847	14,508,711
Time deposits	<u>62,792,174</u>	<u>48,365,686</u>
Total deposits	\$ 82,948,700	\$ 69,410,928
Accrued expenses and other liabilities	1,005,448	749,861
Commitments and contingencies	<u> --</u>	<u> --</u>
Total liabilities	<u>\$ 83,954,148</u>	<u>\$ 70,160,789</u>
 Shareholders' Equity		
Preferred stock, par value \$5 per share, authorized 5,000,000 shares; no shares issued and outstanding	\$ --	\$ --
Common stock, par value \$5 per share, authorized 10,000,000 shares; issued and outstanding 610,175 shares in 2007; issued and outstanding 607,675 shares in 2006	3,050,875	3,038,375
Capital surplus	9,130,243	9,090,243
Retained (deficit)	(724,288)	(821,595)
Accumulated other comprehensive income (loss)	<u>49,123</u>	<u>(280,286)</u>
Total shareholders' equity	<u>\$ 11,505,953</u>	<u>\$ 11,026,737</u>
 Total liabilities and shareholders' equity	 <u>\$ 95,460,101</u>	 <u>\$ 81,187,526</u>

See Accompanying Notes to Financial Statements.

COLONIAL VIRGINIA BANK

Statements of Operations

For the Years Ended December 31, 2007 and 2006

	2007	2006
Interest and Dividend Income		
Interest and fees on loans	\$ 4,574,446	\$ 3,833,360
Interest on securities		
Taxable	1,228,830	684,208
Dividends	20,371	19,205
Interest on federal funds sold	396,230	395,273
Total interest and dividend income	\$ 6,219,877	\$ 4,932,046
Interest Expense, interest on deposits	\$ 3,131,529	\$ 2,069,645
Net interest income	\$ 3,088,348	\$ 2,862,401
Provision for Loan Losses	190,700	29,200
Net interest income after provision for loan losses	\$ 2,897,648	\$ 2,833,201
Other Income		
Service charges on deposit accounts	\$ 87,475	\$ 67,229
Income on bank owned life insurance	39,943	24,276
Net gain on called securities	2,016	--
Other service charges, commissions and fees	144,762	117,605
Total other income	\$ 274,196	\$ 209,110
Other Expenses		
Salaries and employee benefits	\$ 1,648,545	\$ 1,464,084
Occupancy expense	194,009	208,944
Furniture and equipment expense	69,867	56,723
Data processing	437,030	414,408
Advertising	137,023	84,342
Professional fees	110,168	73,205
Stationery and supplies	41,368	37,155
Postage and freight	35,843	33,983
Regulatory assessments	63,079	24,075
Insurance	35,913	37,870
Franchise tax	62,418	86,752
Directors fees	68,200	57,400
Charitable contributions	314,983	13,151
Other operating expenses	79,406	87,633
Total other expenses	\$ 3,297,852	\$ 2,679,725

See Accompanying Notes to Financial Statements.

COLONIAL VIRGINIA BANK

Statements of Operations

(Continued)

For the Years Ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Net income (loss) before income taxes	\$ (126,008)	\$ 362,586
Income Tax (Benefit)	<u>(223,315)</u>	<u>(206,008)</u>
Net income	<u>\$ 97,307</u>	<u>\$ 568,594</u>
Earnings per Share, basic	<u>\$ 0.16</u>	<u>\$ 0.94</u>
Earnings per Share, diluted	<u>\$ 0.16</u>	<u>\$ 0.93</u>
Weighted Average Shares Outstanding, basic	<u>609,011</u>	<u>606,648</u>
Weighted Average Shares Outstanding, diluted	<u>615,150</u>	<u>613,910</u>

See Accompanying Notes to Financial Statements.

COLONIAL VIRGINIA BANK

Statements of Changes in Shareholders' Equity
For the Years Ended December 31, 2007 and 2006

	Common Stock	Capital Surplus	Retained (Deficit)	Accumulated Other Compre- hensive Income (Loss)	Compre- hensive Income	Total
Balance at December 31, 2005	\$ 3,025,875	\$ 9,050,243	\$ (1,390,189)	\$ (117,735)		\$ 10,568,194
Comprehensive income:						
Net income	--	--	568,594	--	\$ 568,594	568,594
Other comprehensive income, unrealized loss on securities available for sale	--	--	--	48,395	<u>48,395</u>	48,395
Total comprehensive income	--	--	--	--	<u>\$ 616,989</u>	
Adjustment to initially apply SFAS No. 158	--	--	--	(210,946)		(210,946)
Exercise of stock options	<u>12,500</u>	<u>40,000</u>	<u>--</u>	<u>--</u>		<u>52,500</u>
Balance at December 31, 2006	\$ 3,038,375	\$ 9,090,243	\$ (821,595)	\$ (280,286)		\$ 11,026,737
Comprehensive income:						
Net income	--	--	97,307	--	\$ 97,307	97,307
Other comprehensive income, Change in unrealized loss on securities available for sale (net of tax \$86,844)	--	--	--	--	237,919	-
Change in pension liability (net of tax \$61,538)	--	--	--	--	<u>91,490</u>	-
Other comprehensive gain (net of tax \$148,382)	--	--	--	329,409	<u>329,409</u>	329,409
Total comprehensive income	--	--	--	--	<u>\$ 426,716</u>	
Exercise of stock options	<u>12,500</u>	<u>40,000</u>	<u>--</u>	<u>--</u>		<u>52,500</u>
Balance at December 31, 2007	<u>\$ 3,050,875</u>	<u>\$ 9,130,243</u>	<u>\$ (724,288)</u>	<u>\$ 49,123</u>		<u>\$ 11,505,953</u>

COLONIAL VIRGINIA BANK

Statements of Cash Flows

For the Years Ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Cash Flows From Operating Activities		
Reconciliation of net income to net cash provided by operating activities:		
Net income	\$ 97,307	\$ 568,594
Net amortization (accretion) on investment securities	(91,823)	(79,591)
Deferred income tax benefit	(223,315)	(206,008)
Depreciation and amortization	264,581	309,858
Contribution of land	303,089	--
Provision for loan losses	190,700	29,200
Changes in assets and liabilities:		
(Increase) in accrued interest and other assets	(190,131)	(418,956)
Increase in accrued expenses and other liabilities	285,540	269,218
Net cash provided by operating activities	<u>\$ 635,948</u>	<u>\$ 472,315</u>
Cash Flows From Investing Activities		
Purchases of securities available for sale	\$ (17,910,702)	\$ (12,087,693)
Principal paydowns of securities	2,218,432	1,159,522
Proceeds from calls and maturities of securities available for sale	7,300,579	1,814,195
Purchase of securities held to maturity	(1,009,100)	(3,753,082)
Proceeds from calls and maturities of securities held to maturity	1,506,031	--
(Purchase) of Federal Reserve Stock	(21,550)	(12,850)
(Purchase) of Federal Home Loan Bank Stock	(160,600)	--
Net (increase) in loans	(7,723,782)	(6,779,114)
Increase in bank owned life insurance	(539,943)	(524,276)
Purchases of premises and equipment	(62,662)	(172,141)
Net cash (used in) investing activities	<u>\$ (16,403,297)</u>	<u>\$ (20,355,439)</u>
Cash Flows From Financing Activities		
Net increase (decrease) in demand, savings, interest-bearing checking and money market deposits	\$ (888,716)	\$ 1,469,816
Net increase in time deposits	14,426,488	17,781,819
Proceeds from exercise of stock options	52,500	52,500
Net cash provided by financing activities	<u>\$ 13,590,272</u>	<u>\$ 19,304,135</u>
Net (decrease) in cash and cash equivalents	\$ (2,177,077)	\$ (578,989)
Cash and Cash Equivalents		
Beginning	<u>7,108,048</u>	<u>7,687,037</u>
Ending	<u>\$ 4,930,971</u>	<u>\$ 7,108,048</u>

COLONIAL VIRGINIA BANK

Statements of Cash Flows (continued)

For the Years Ended December 31, 2007 and 2006

Supplemental Disclosure of Cash Flow Information,

cash paid for interest	<u>\$ 3,054,910</u>	<u>\$ 1,809,422</u>
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Supplemental Disclosure of Noncash Activities,

unrealized gain on securities available for sale, net	<u>\$ 237,919</u>	<u>\$ 48,395</u>
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change in pension liability, net	<u>\$ 91,490</u>	<u>\$ (210,946)</u>
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See Accompanying Notes to Financial Statements.

COLONIAL VIRGINIA BANK

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

Significant Accounting Policies

The accounting and reporting policies of Colonial Virginia Bank (the “Bank”) are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. The more significant of these policies are summarized below.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing balances with banks and federal funds sold. Generally, federal funds are purchased and sold for one day periods.

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as “held to maturity” and recorded at amortized cost. Securities not classified as held to maturity, including equity securities with readily determinable fair values, are classified as “available for sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Other restricted securities, such as Federal Reserve Bank stock, are carried at cost.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Loans

The Bank grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by commercial loans throughout the Middle Peninsula area of Virginia. The ability of the Bank’s debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for the allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination and commitment fees and certain direct costs are deferred and the net amount is

Notes to Financial Statements

amortized as an adjustment of the related loan's yield. The Bank is amortizing these amounts over the loan's contractual life.

The accrual of interest on mortgage, commercial and consumer loans is discontinued at the time the loan becomes 90 days delinquent unless the credit is well-secured and in process of collection. Non-performing loans are placed either in nonaccrual status pending further collection efforts or charged off if collection of principal or interest is considered doubtful.

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

Allowance for Loan Losses

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

The Bank monitors and maintains an allowance for loan and lease losses ("ALLL") to absorb an estimate of probable losses inherent in the loan portfolio. The Bank maintains policies and procedures that address the systems of controls over the following areas of maintenance of the allowance: the systematic methodology used to determine the appropriate level of the allowance to provide assurance that the systems are maintained in accordance with accounting principles generally accepted in the United States of America; the accounting policies for loan charge-offs and recoveries; the assessment and measurement of impairment in the loan portfolio; and the loan grading system. The Bank uses an internal risk rating system and assigns a numeric rating to each loan based on multiple criteria, including but not limited to a borrower's credit history (evidenced by credit bureau reporting), collateral and its supporting value, type of work or industry in which the borrower is involved, and any noted exceptions to internal policy. Varying percentages of outstanding balances by risk rating are used in determining the adequacy of the ALLL. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash

Notes to Financial Statements

flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance, homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures. Impairments are charged to the allowance. Repossessions totaled \$55,000 at December 31, 2007, compared to \$0 at December 31, 2006.

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 assets' estimated useful lives. Estimated useful lives range from 10 to 39 years for buildings and 3 to 7 years for furniture, fixtures and equipment.

Foreclosed Properties and Repossessed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale. They are initially recorded at the lower of the Bank's cost or the assets' fair market value at the date of foreclosure, less estimated selling costs thus establishing a new cost basis. Subsequent to foreclosure, valuations of the assets are periodically performed by management. Adjustments are made to the lower of the carrying amount or fair market value of the assets less selling costs. Revenue and expenses from operations and valuation changes are included in net expenses from repossessed assets. Repossessed assets totaled \$55,000 at December 31, 2007. The Bank had no foreclosed assets during the year ended December 31, 2006. An additional write-down of \$10,000 was recorded subsequent to repossession and is included in non-interest expense on the income statement.

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ 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, the valuation of foreclosed real estate and the valuation allowance of deferred tax assets.

Income Taxes

Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences, operating loss carry forwards, and tax credit carry forwards. Deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Notes to Financial Statements

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

Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the statement of income.

Advertising Costs

The Bank follows the policy of charging the production costs of advertising to expense as incurred. The Bank expensed \$137,023 and \$84,342 for advertising costs for the years ended December 31, 2007 and 2006, respectively.

Comprehensive Income

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

Earnings Per Share

Basic earnings per share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Bank relate solely to outstanding stock options, and are determined using the treasury stock method.

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board (“FASB”) issued Statement No. 123 (revised 2004), “Share-Based Payment”. SFAS No. 123(R) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. SFAS No. 123(R) 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

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plans. SFAS No 123(R) is a replacement of SFAS No. 123, “Accounting for Stock-Based Compensation”, and supersedes Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees”, and its related interpretive guidance. The effect of the Statement will be to require entities to measure the cost of employee services received in exchange for stock options based on the grant-date fair value of the award, and to recognize the cost over the period the employee is required to provide services for the award. SFAS No. 123(R) permits entities to use any option-pricing model that meets the fair value objective in the Statement.

The Bank elected to adopt SFAS No. 123(R) on January 1, 2006 under the modified prospective method. Compensation cost for grants after this date will be measured using the fair value of an award on the grant dates and recognized over the service period, which is usually the vesting period. There were no stock options granted in 2006 or 2007.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, “Fair Value Measurements” (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather, provides enhanced guidance to other pronouncements that require or permit assets or liabilities to be measured at fair value. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those years. The FASB approved a one-year deferral for the implementation of the Statement for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Bank does not expect the implementation of SFAS 157 to have a material impact on its financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)” (SFAS 158). This Statement requires that employers measure plan assets and obligations as of the balance sheet date. This requirement is effective for fiscal years ending after December 15, 2008. The other provisions of SFAS 158 were implemented by the Bank as of December 31, 2006. The Bank does not anticipate the implementation to have a material impact on its financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (SFAS 159). This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of this Statement is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The fair value option established by this Statement permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option may be applied instrument by instrument and is irrevocable. SFAS 159 is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007,

Notes to Financial Statements

with early adoption available in certain circumstances. The Bank is in the process of evaluating the impact SFAS 159 may have on its financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), "Business Combinations" (SFAS 141(R)). The Standard will significantly change the financial accounting and reporting of business combination transactions. SFAS 141(R) establishes principles for how an acquirer recognizes and measures the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for acquisition dates on or after the beginning of an entity's first year that begins after December 15, 2008. The Bank does not expect the implementation of SFAS 141(R) to have a material impact on its financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, "Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51" (SFAS 160). The Standard will significantly change the financial accounting and reporting of noncontrolling (or minority) interests in consolidated financial statements. SFAS 160 is effective as of the beginning of an entity's first fiscal year that begins after December 15, 2008, with early adoption prohibited. The Bank does not expect the implementation of SFAS 160 to have a material impact on its financial statements.

In September 2006, the Emerging Issues Task Force (EITF) issued EITF 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." This consensus concludes that for a split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with SFAS 106 (if, in substance, a postretirement benefit plan exists) or APB Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. The consensus is effective for fiscal years beginning after December 15, 2007, with early application permitted. The Bank is evaluating the effect that EITF 06-4 will have on its financial statements when implemented.

In November 2006, the EITF issued "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements" (EITF 06-10). In this Issue, a consensus was reached that an employer should recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either SFAS 106 or APB Opinion No. 12, as appropriate, if the employer has agreed to maintain a life insurance policy during the employee's retirement or provide the employee with a death benefit based on the substantive agreement with the employee. A consensus also was reached that an employer should recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement. The consensus are effective for fiscal years beginning after December 15, 2007, including interim periods within those fiscal years, with early application permitted. The Bank is evaluating the effect that EITF 06-10 will have on its financial statements when implemented.

In February 2007, the FASB issued FSP No. FAS 158-1, "Conforming Amendments to the Illustrations in FASB Statements No. 87, No. 88 and No. 106 and to the Related Staff Implementation Guides." This FSP provides conforming amendments to the illustrations in SFAS

Notes to Financial Statements

87, 88, and 106 and to related staff implementation guides as a result of the issuance of SFAS 158. The conforming amendments made by this FSP are effective as of the effective dates of SFAS 158. The unaffected guidance that this FSP codifies into SFAS 87, 88, and 106 does not contain new requirements and therefore does not require a separate effective date or transition method. The Bank does not expect the implementation of FSP No. FAS 158-1 to have a material impact on its financial statements.

In November 2007, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 109, "Written Loan Commitments Recorded at Fair Value Through Earnings" (SAB 109). SAB 109 expresses the current view of the staff that the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SEC registrants are expected to apply the views in Question 1 of SAB 109 on a prospective basis to derivative loan commitments issued or modified in fiscal quarters beginning after December 15, 2007. The Bank does not expect the implementation of SAB 109 to have a material impact on its financial statements.

In December 2007, the SEC issued Staff Accounting Bulletin No. 110, "Use of a Simplified Method in Developing Expected Term of Share Options" (SAB 110). SAB 110 expresses the current view of the staff that it will accept a company's election to use the simplified method discussed in SAB 107 for estimating the expected term of "plain vanilla" share options regardless of whether the company has sufficient information to make more refined estimates. The staff noted that it understands that detailed information about employee exercise patterns may not be widely available by December 31, 2007. Accordingly, the staff will continue to accept, under certain circumstances, the use of the simplified method beyond December 31, 2007. The Bank does not expect the implementation of SAB 110 on future stock option grants to have a material impact on its financial statements.

Note 2. Securities

Amortized cost and fair values of securities available for sale at December 31, 2007, were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized (Losses)</u>	<u>Fair Value</u>
Securities of U.S. government and federal agencies	\$ 12,161,125	\$ 160,930	\$ (5,071)	\$ 12,316,984
Mortgage-backed securities	13,256,816	115,703	(16,416)	13,356,103
Securities of states and political subdivisions	348,492	845	(567)	348,770
Restricted stock	511,550	--	--	511,550
Total	<u>\$ 26,277,983</u>	<u>\$ 277,478</u>	<u>\$ (22,054)</u>	<u>\$ 26,533,407</u>

Notes to Financial Statements

Amortized cost and fair values of securities available for sale at December 31, 2006, were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized (Losses)</u>	<u>Fair Value</u>
Securities of U.S. government and federal agencies	\$ 13,104,246	\$ 27,980	\$ (44,762)	\$ 13,087,464
Mortgage-backed securities	4,016,634	3,971	(54,548)	3,966,057
Securities of states and political subdivisions	98,234	--	(1,981)	96,253
Restricted stock	<u>329,400</u>	<u>--</u>	<u>--</u>	<u>329,400</u>
Total	<u>\$ 17,548,514</u>	<u>\$ 31,951</u>	<u>\$ (101,291)</u>	<u>\$ 17,479,174</u>

Amortized cost and fair values of securities held to maturity at December 31, 2007, were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized (Losses)</u>	<u>Fair Value</u>
Securities of U.S. government and federal agencies	\$ 2,633,471	\$ 24,901	\$ --	\$ 2,658,372
Mortgage-backed securities	<u>570,435</u>	<u>--</u>	<u>(1,293)</u>	<u>569,142</u>
Total	<u>\$ 3,203,906</u>	<u>\$ 24,901</u>	<u>\$ (1,293)</u>	<u>\$ 3,227,514</u>

Notes to Financial Statements

Amortized cost and fair values of securities held to maturity at December 31, 2006, were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized (Losses)</u>	<u>Fair Value</u>
Securities of U.S. government and federal agencies	\$ 2,906,830	\$ 12,857	\$ (892)	\$ 2,918,795
Mortgage-backed securities	657,940	581	--	658,521
Securities of states and political subdivisions	199,873	--	(29)	199,844
Total	<u>\$ 3,764,643</u>	<u>\$ 13,438</u>	<u>\$ (921)</u>	<u>\$ 3,777,160</u>

Securities pledged to secure deposits of the Commonwealth of Virginia totaled approximately \$1,100,000 and \$100,000 at December 31, 2007 and 2006, respectively.

The amortized cost and fair value of securities available for sale and held to maturity at December 31, 2007, by contractual maturity are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations without penalties.

	<u>Available for Sale</u>		<u>Held to Maturity</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
One to five years	\$ 8,475,611	\$ 8,518,088	\$ 1,629,790	\$ 1,645,472
Five to ten years	7,031,645	7,145,718	1,003,681	1,012,900
After ten years	10,259,177	10,358,051	570,435	569,142
Restricted securities	511,550	511,550	--	--
Total	<u>\$ 26,277,983</u>	<u>\$ 26,533,407</u>	<u>\$ 3,203,906</u>	<u>\$ 3,227,514</u>

For the years ended December 31, 2007 and 2006, proceeds from calls of securities available for sale totaled \$2,422,277 and \$0, respectively. Gross realized gains of \$1,439 and \$0 and gross realized losses of \$534 and \$0 were recognized on those calls, respectively.

For the years ended December 31, 2007 and 2006, proceeds from calls of securities held to maturity totaled \$1,056,031 and \$0, respectively. Gross realized gains of \$1,111 and \$0 and there were no gross realized losses on those calls, respectively.

At December 31, 2007, 22 investment securities had an unrealized loss. The investment securities are obligations of entities that are excellent credit risks. The temporary impairment noted is the

Notes to Financial Statements

result of market conditions and does not reflect on the ability of the issuers to repay the obligations. There were 13 investment securities held at December 31, 2007 that had been in an unrealized loss position for greater than 12 months. These 13 securities had a total unrealized loss of \$16,772 and a market value of \$2,552,855 at December 31, 2007. The remaining 9 securities had a total unrealized loss of \$6,575 and a market value of \$3,533,064 at December 31, 2007. The Bank has the intent and the ability to hold these securities until such time as there is a recovery of the unrealized loss or until maturity.

2007	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
Description of Securities						
Obligations of U.S. government and federal agencies	\$999,800	(\$71)	\$1,245,000	(\$5,000)	\$2,244,800	(\$5,071)
Mortgage backed securities	2,435,339	(5,937)	1,307,855	(11,772)	3,743,194	(17,709)
Securities of states and political subdivisions	97,925	(567)	--	--	97,925	(567)
Total temporarily Impaired securities	<u>\$3,533,064</u>	<u>(\$6,575)</u>	<u>\$2,552,855</u>	<u>(\$16,772)</u>	<u>\$6,085,919</u>	<u>(\$23,347)</u>

2006	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)	Fair Value	Unrealized (Losses)
Description of Securities						
Obligations of U.S. government and federal agencies	\$5,609,010	(\$3,237)	\$3,239,080	(\$42,417)	\$8,848,090	(\$45,654)
Mortgage backed securities	130,516	(20)	2,786,039	(54,528)	2,916,555	(54,548)
Securities of states and political subdivisions	199,844	(29)	96,253	(1,981)	296,097	(2,010)
Total temporarily Impaired securities	<u>\$5,939,370</u>	<u>(\$3,286)</u>	<u>\$6,121,373</u>	<u>(\$98,926)</u>	<u>\$12,060,742</u>	<u>(\$102,212)</u>

Notes to Financial Statements

Note 3. Loans

The loan portfolio was composed of the following at the dates indicated:

	December 31,	
	2007	2006
Mortgage:		
Construction and land development	\$ 13,481,473	\$ 9,299,922
Residential real estate	15,032,853	13,329,893
Nonresidential	9,227,496	8,751,165
Commercial	11,580,579	9,997,371
Agricultural and other farm loans	545,586	546,714
Consumer and all other loans	4,407,673	4,661,667
	\$ 54,275,660	\$ 46,586,732
Allowance for loan losses	491,383	329,462
Unearned income	125,773	131,848
Loans, net	\$ 53,658,504	\$ 46,125,422

Overdrafts totaling \$14,767 and \$14,618 at December 31, 2007 and 2006, respectively, were reclassified from deposits to loans.

Loans past due 90 days or more and still accruing interest at December 31, 2007 and December 31, 2006 were \$1,254 and \$25,906, respectively.

The following is a summary of information pertaining to impaired and non-accrual loans:

	December 31,	
	2007	2006
	<i>(in thousands)</i>	
Impaired loans without a valuation allowance	\$ 1,052	\$ 14
Impaired loans with a valuation allowance	-	-
Total impaired loans	\$ 1,052	\$ 14
Valuation allowance related to impaired loans	\$ -	\$ -
Total non-accrual loans	\$ 8	\$ -
Total loans past due ninety days or more and still accruing	\$ 1	\$ -

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	Years Ended December 31,	
	2007	2006
	<i>(in thousands)</i>	
Average investment in impaired loans	\$ 1,085	\$ 579
Interest income recognized on impaired loans	\$ 107	\$ 216
Interest income recognized on a cash basis on impaired loans	\$ 107	\$ 216

No additional funds are committed to be advanced in connection with impaired loans.

An analysis of the allowance for loan losses was as follows for the periods indicated:

	December 31,	
	2007	2006
Balance at the beginning of the period	\$ 329,462	\$ 316,372
Provision for loan losses	190,700	29,200
Loans charged off	(31,621)	(16,611)
Recoveries on loans previously charged off	2,842	501
Balance at the end of the period	\$ 491,383	\$ 329,462

Note 4. Premises and Equipment

A summary of the cost and accumulated depreciation of premises and equipment follows:

	December 31,	
	2007	2006
Bank building and improvements	\$ 2,072,511	\$ 2,137,654
Land and land improvements	1,431,722	1,755,399
Furniture, fixtures and equipment	1,201,635	1,057,421
Construction in progress	25,496	21,318
	\$ 4,731,364	\$ 4,971,792
Less accumulated depreciation	977,620	713,039
	\$ 3,753,744	\$ 4,258,753

Depreciation expense for the years ended December 31, 2007 and 2006 totaled \$264,581 and \$309,858, respectively. Land contributed to a non-profit organization amounted to \$303,089 and is included in contributions on the income statement.

As of December 31, 2007, the Bank had no lease agreements.

Notes to Financial Statements

Note 5. Borrowings

The Bank has unsecured lines of credit with correspondent banks totaling \$7,100,000 available for overnight borrowing.

Note 6. Related Party Transactions

In the normal course of business, the Bank extends credit to directors and executive officers. The aggregate amount of outstanding loans at December 31, 2007 and 2006 totaled \$1,980,442 and \$4,005,150, respectively. During the year ended December 31, 2007, total principal additions were \$1,307,181 and total principal repayments were \$3,331,889.

Deposits from related parties totaled \$5,199,474 and \$4,895,573 at December 31, 2007 and 2006, respectively.

Note 7. Time Deposits

The aggregate amount of time deposits in denominations of \$100,000 or more at December 31, 2007 and 2006 was \$23,807,990 and \$17,429,671, respectively.

At December 31, 2007, the scheduled maturities on certificates of deposit are as follows:

2008	\$ 59,045,336
2009	3,690,043
2010	46,252
2011	10,543
	<u>\$ 62,792,174</u>

The Bank does not actively engage deposit brokers or hold any traditional “brokered” deposits. However, the state of Virginia has engaged Community Bankers Bank of Virginia (“CBB”) to manage excess funds within the state treasury through short-term (typically 182 days) CDs with participating Virginia banks. The Bank began participating in this program in 2007, and at December 31, 2007, held \$2.0 million of these state CDs. Due to the management function provided by CBB, the deposits are technically regarded as “brokered” deposits.

Note 8. Income Taxes

The Bank files income tax returns in the U.S. federal jurisdiction and the state of Virginia. With few exceptions, the Bank is no longer subject to U.S. federal and state income tax examinations by tax authorities for years prior to 2004.

The Bank adopted the provision of FIN 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007 with no impact on the financial statements.

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2007 and 2006 are presented below:

Notes to Financial Statements

	December 31,	
	2007	2006
Deferred Tax Assets:		
Net operating loss carry forward	\$ 48,700	\$ 206,008
Allowance for loan losses	150,756	92,807
Organizational and start-up expenses	24,891	54,760
Deferred compensation	136,460	65,040
FAS 158 pension adjustment	61,538	71,722
Contributions carryover	114,238	7,144
Unrealized losses on securities available for sale	--	23,577
	\$ 536,583	\$ 521,058
Deferred Tax Liabilities:		
Bank premises and equipment	45,722	52,858
Unrealized gains on securities	86,844	-
	\$ 404,017	\$ 468,200
Less: Valuation Allowance	--	(262,192)
Net Deferred Tax Assets	\$ 404,017	\$ 206,008

The provision for income taxes charged to operations for the years ended December 31, 2007 and 2006:

	2007	2006
Current tax expense	\$ --	\$ --
Deferred tax expense	38,877	18,409
Change in valuation allowance	(262,192)	(224,417)
	\$ (223,315)	\$ (206,008)

Under the provisions of the Internal Revenue Code, the Bank has approximately \$143,235 of net operating loss carry forwards which can be offset against future taxable income. The carry forwards expire December 31, 2024. Contribution carry forwards totaling approximately \$335,994 expire December 31, 2012.

Note 9. Financial Instruments with Off-Balance-Sheet Risk

The Bank is party to credit related 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 commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.

The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policies in making commitments as it does

Notes to Financial Statements

for on-balance-sheet instruments.

The following financial instruments were outstanding whose contract amounts represent credit risk:

	December 31,	
	2007	2006
	(in thousands)	
Commitments to grant loans	\$ 1,538	\$ 6,231
Unfunded commitments under lines of credit	14,012	14,215
Commercial and standby letters of credit	309	895

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. The commitments for equity lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments, if deemed necessary.

The Bank maintains its cash accounts in several correspondent banks. The amount by which cash on deposit in those banks exceeds the federally insured limits totaled \$401,621 and \$455,820 at December 31, 2007 and 2006, respectively.

Note 10. Stock Option Plan

During 2004, the Bank adopted an incentive stock plan under which options may be granted to certain key employees and directors for purchase of the Bank's common stock. The effective date of the plan was June 16, 2004, with an expiration date of June 16, 2014. The plan reserves for issuance 75,000 shares of the Bank's voting common stock. The stock option plan requires that options be granted at an exercise price equal to at least 100% of the fair market value of the common stock on the date of the grant. Such options are generally not exercisable until one year from the date of issuance. The options will expire in no more than ten years after the date of grant. All options granted under the plan were vested as of December 31, 2005, and there were no grants under the plan in 2006 or 2007. Therefore, no compensation expense has been recognized.

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A summary of the status of the Bank's stock option plan is presented below:

	2007		Aggregate Intrinsic Value (1)	2006	
	Shares	Average Exercise Price		Shares	Average Exercise Price
Outstanding at beginning of year	37,354	\$ 21.26		39,854	\$ 21.24
Granted	--			--	
Exercised	(2,500)	21.00		(2,500)	21.00
Expired	<u>(2,500)</u>	21.00		<u>--</u>	21.00
Outstanding at end of year	<u>32,354</u>	\$ 21.30	\$ 25,839	<u>37,354</u>	\$ 21.26
Options exercisable, end of year	32,354	\$ 21.30	\$ 25,839	37,354	\$ 21.26
Weighted average fair value of options granted during the year	\$ --			\$ --	

(1)The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on December 31, 2007. This amount changes based on changes in the market value of the Bank's stock.

Information pertaining to options outstanding at December 31, 2007 is as follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$20.00 - \$22.00	<u>32,354</u>	6.7 years	\$ 21.30	<u>32,354</u>	\$ 21.30

Note 11. Employee Benefits

In October 2004, the Bank implemented a Supplemental Executive Retirement Plan ("SERP") in order to attract future executives and retain current executives as well as to provide additional deferred compensation benefits for such employees. Currently, these benefits are available only to the Bank's Chief Executive Officer and Chief Financial Officer. Under the SERP plan, each of the executive officers is entitled to receive retirement benefits in an amount that is based on a fixed percentage of their final three year average of total salary including bonuses, if any, depending on their age at retirement (giving effect to certain present value calculations and salary increase assumptions). Given the executives remain at the Bank until they reach age 65, they will be entitled to receive the maximum benefit of 55% of their final three years' average salary. These benefits become payable upon the officer's retirement and will be paid to the individual over a period of 15 years commencing with the first year following the retirement. Because the SERP plan also provides death benefits, no

Notes to Financial Statements

retirement benefits are paid following the death of the executive.

The Bank records periodic accruals for the cost of providing such benefits by charges to income. The amount expensed is impacted by actuarial assumptions including an annual discount rate of 6.00% and an assumed annual salary increase of 3.00%. The Bank expensed \$210,060 and \$161,139 during the years ended December 31, 2007 and 2006, respectively, for the SERP plan. In addition, the Bank implemented SFAS No. 158 during 2006, which required an initial implementation adjustment of \$210,946 recorded as a reduction in accumulated other comprehensive income. This amount will be amortized into expense over the period in which the two covered executive officers reach full retirement age of 65. Amortization included in expense in 2007 totaled \$29,957. Total SERP expense including amortization of the implementation adjustment expected for 2008 is \$210,060.

In order to fund the SERP plan, the Bank purchased life insurance policies aggregating \$6.5 million on the lives of the executives included in the SERP plan. The Bank is the owner and beneficiary of these policies. The policies had an aggregate cash surrender value to the Bank of \$2,089,533 and \$1,549,590 at December 31, 2007 and 2006, respectively, which is reflected in other assets on the Bank's Balance Sheets.

	2007	2006
Change in Benefit Obligation		
Projected Benefit Obligation, Beginning of the Year	\$ 402,240	\$ 30,155
Service cost	150,359	141,624
Interest cost	29,749	19,515
FAS No. 158 Implementation Adjustment	-	210,946
Projected Benefit Obligation, End of the Year	\$ 582,348	\$ 402,240
Amounts Recognized in the Balance Sheet		
Other assets, deferred income tax benefit	\$ 61,538	\$ -
Other liabilities, accrued SERP liability	582,348	402,240
Amounts Recognized in Accumulated Other Comprehensive Loss (Income)		
Accrued SERP liability	\$ 180,994	\$ 210,946
Deferred income tax benefit	(61,538)	-
	\$ 119,456	\$ 210,946
Components of Net Periodic Benefit Cost		
Service cost	\$ 150,359	\$ 141,624
Interest cost	29,749	19,515
Amortization of prior service cost	29,952	-
Net Periodic Benefit Cost	\$ 210,060	\$ 161,139

Notes to Financial Statements

	2007	2006
Other Changes in Benefit Obligations		
Recognized in Other Comprehensive Loss (Income)		
FAS No. 158 Implementation Adjustment	\$ - -	\$ 210,946
Amortization of prior service cost	(29,952)	- -
Total recognized in other comprehensive income	\$ (29,952)	\$ 210,946
 Total Recognized in Net Periodic Benefit Cost and Other Comprehensive Loss	 \$ 180,108	 \$ 372,085

The following benefit payments reflecting the appropriate expected future service are expected to be paid:

<u>Pension Benefits</u>	
(in thousands)	
2011	\$ 46
2012	92
2013 – 2017	497

401(k) Plan

The Bank currently has a 401(k) defined contribution plan applicable to all eligible employees. Currently, the Bank does not make contributions to the Plan, but may in the future based on the discretion of the Board of Directors. Employees may elect to contribute to the Plan an amount up to 100% of their salary, not to exceed the maximum contribution allowed by the Internal Revenue Service. There is no Bank common stock included in the 401(k) Plan assets.

Note 12. Regulatory Requirements

Under regulatory guidelines, the Bank may pay dividends only out of its retained earnings. However, regulatory authorities may limit the payment of dividends by any bank when it is determined that such a limitation is necessary to ensure financial soundness. At December 31, 2007, there are no retained earnings available from which to pay dividends.

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, financial institutions must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. A financial institution's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require financial institutions to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2007, that the Bank meets all capital adequacy requirements to which it is

Notes to Financial Statements

subject.

As of December 31, 2007, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Bank's actual capital amounts and ratios as of December 31, 2007 and 2006 are also presented in the table.

	Actual		Minimum Capital Requirement		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
	(Amounts in Thousands)					
As of December 31, 2007:						
Total Capital (to Risk						
Weighted Assets)	\$ 11,948	18.26%	\$ 5,235	8.00%	\$ 6,544	10.00%
Tier 1 Capital (to Risk						
Weighted Assets)	\$ 11,457	17.51%	\$ 2,618	4.00%	\$ 3,926	6.00%
Tier 1 Capital (to						
Average Assets)	\$ 11,457	12.13%	\$ 3,778	4.00%	\$ 4,722	5.00%
As of December 31, 2006:						
Total Capital (to Risk						
Weighted Assets)	\$ 11,636	20.77%	\$ 4,481	8.00%	\$ 5,602	10.00%
Tier 1 Capital (to Risk						
Weighted Assets)	\$ 11,307	20.18%	\$ 2,241	4.00%	\$ 3,361	6.00%
Tier 1 Capital (to						
Average Assets)	\$ 11,307	14.14%	\$ 3,200	4.00%	\$ 4,000	5.00%

Note 13. Fair Value of Financial Instruments and Interest Rate Risk

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank'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. SFAS No. 107 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Bank.

Notes to Financial Statements

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

Cash, short-term investments and federal funds sold: The carrying amounts of cash and short-term instruments approximate fair values. The carrying amounts of interest-bearing deposits maturing within 90 days approximate their fair values.

Securities: Fair values for securities, excluding restricted stock, are based on quoted market prices. The carrying value of restricted stock approximates fair value based on the redemption provisions of the respective entity.

Loans: For certain homogeneous categories of loans, such as some residential mortgages, and other consumer loans, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Deposits: The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

Accrued interest: The carrying amounts of accrued interest approximate fair value.

Off-balance-sheet instruments: Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of standby letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At December 31, 2007 and 2006, the fair value of loan commitments and standby letters of credit were immaterial.

The estimated fair values and related carrying amounts of the Bank's financial instruments are as follows:

	2007		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(In Thousands)		(In Thousands)	
Financial Assets:				
Cash and short-term investments	\$4,931	\$4,931	\$7,108	\$7,108
Securities	29,737	29,761	21,244	21,256
Loans, net	53,659	53,943	46,125	46,159
Accrued interest receivable	537	537	401	401
Financial Liabilities:				
Deposits	\$82,949	\$83,070	\$69,411	\$67,383
Accrued interest payable	365	365	289	289

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

Note 14. Earnings Per Share

The following shows the weighted average number of shares used in computing earnings per share and the effect on the weighted average shares of diluted potential common stock. Potential dilutive common stock had no effect on income available to common shareholders.

	2007		2006	
	Shares	Per Share Amount	Shares	Per Share Amount
Basic earnings per share	609,011	\$ 0.16	606,648	\$ 0.94
Effect of dilutive securities,				
Stock options	<u>6,139</u>		<u>7,262</u>	
Diluted earnings per share	<u>615,150</u>	<u>\$ 0.16</u>	<u>613,910</u>	<u>\$ 0.93</u>

Item 8. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Item 8A(T). Controls and Procedures

As of the end of the period covered by this report, the Bank carried out an evaluation, under the supervision and with the participation of the Bank's management, including the Bank's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Bank's disclosure controls and procedures pursuant to Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, the Bank's Chief Executive Officer and Chief Financial Officer concluded that the Bank's disclosure controls and procedures are effective in timely alerting them to material information relating to the Bank required to be included in the Bank's periodic filings with the Board of Governors of the Federal Reserve System.

Management is responsible for establishing and maintaining adequate internal controls over financial reporting (as defined in Rule 13a-15(f) or 15d-15(f) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In order to evaluate the effectiveness of internal control over financial reporting, as required by Rule 13(a)-15(c) of the Exchange Act, management conducted an assessment using the criteria established in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has concluded that as of December 31, 2007, our internal control over financial reporting was effective.

This annual report does not include an attestation report of the company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the company to provide only management's report in this annual report.

There were no changes in the Bank's internal control over financial reporting identified in connection with the evaluation of it that occurred during the quarter that ended December 31, 2007 that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

Item 8B. Other Information

None.

PART III

Item 9. Directors, Executive Officers, Promoters, Control Persons and Corporate Governance; Compliance With Section 16(a) of the Exchange Act

As permitted by Instruction E(3) to Form 10-KSB, the information required by this Item is incorporated by reference to the Bank's definitive Proxy Statement for the 2008 Annual Meeting of Shareholders to be filed within 120 days after the end of the fiscal year.

Item 10. Executive Compensation

As permitted by Instruction E(3) to Form 10-KSB, the information required by this Item is incorporated by reference to the Bank's definitive Proxy Statement for the 2008 Annual Meeting of Shareholders to be filed within 120 days after the end of the fiscal year.

Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

As permitted by Instruction E(3) to Form 10-KSB, the information required by this Item is incorporated by reference to the Bank's definitive Proxy Statement for the 2008 Annual Meeting of Shareholders to be filed within 120 days after the end of the fiscal year.

Item 12. Certain Relationships and Related Transactions, and Corporate Governance

As permitted by Instruction E(3) to Form 10-KSB, the information required by this Item is incorporated by reference to the Bank's definitive Proxy Statement for the 2008 Annual Meeting of Shareholders to be filed within 120 days after the end of the fiscal year.

Item 13. Exhibits

<u>Exhibit Number</u>	<u>Description</u>
3.1	Amended and Restated Articles of Incorporation of Bank, incorporated herein by reference to Exhibit 2(a) to the Form 10-SB, as filed by the Bank with the Federal Reserve of April 29, 2004.
3.2	Bylaws of the Bank, incorporated herein by reference to Exhibit 2(b) to the Form 10-SB, as filed by the Bank with the Federal Reserve of April 29, 2004.
10.1	Executive Employment Agreement, effective as of August 5, 2003, between William J. Farinholt and the Bank, incorporated herein by reference to Exhibit 6(a) to the Form 10-SB, as filed by the Bank with the Federal Reserve of April 29, 2004.
10.2	Executive Employment Agreement, effective as of August 5, 2003 between Kenneth E. Smith and the Bank, incorporated herein by reference to Exhibit 6(b) to the Form 10-SB, as filed by the Bank with the Federal Reserve of April 29, 2004.
10.3	Equity Compensation Plan, incorporated herein by reference to Exhibit 6(c) to the Form 10-SB, as filed by the Bank with the Federal Reserve of April 29, 2004.
31.1	Rule 13a-14(a) Certification of Chief Executive Officer
31.2	Rule 13a-14(a) Certification of Chief Financial Officer
32.1	Statement of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. § 1350

Item 14. Principal Accountant Fees and Services

As permitted by Instruction E(3) to Form 10-KSB, the information required by this Item is incorporated by reference to the Bank's definitive Proxy Statement for the 2008 Annual Meeting of Shareholders to be filed within 120 days after the end of the fiscal year.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

COLONIAL VIRGINIA BANK

Date: March 28, 2008

By: /s/ Kenneth E. Smith
Kenneth E. Smith
Executive Vice President and
Chief Financial Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u> /s/ William J. Farinholt </u> William J. Farinholt	President & Chief Executive Officer (Principal Executive Officer)	March 28, 2008
<u> /s/ Kenneth E. Smith </u> Kenneth E. Smith	Executive Vice President & Chief Financial Officer (Principal Financial Officer)	March 28, 2008
<u> /s/ Kathleen C. Healy </u> Kathleen C. Healy	Vice President & Accounting Officer (Principal Accounting Officer)	March 28, 2008
<u> /s/ Hal D. Bourque </u> Hal D. Bourque	Director	March 28, 2008
<u> /s/ William J. Farinholt </u> William J. Farinholt	Director	March 28, 2008
<u> /s/ Charles F. Dawson </u> Charles F. Dawson	Director	March 28, 2008
<u> /s/ Joseph A. Lombard, Jr. </u> Joseph A. Lombard, Jr.	Director	March 28, 2008

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Kenneth E. Smith</u> Kenneth E. Smith	Director	March 28, 2008
<u>/s/ Joseph F. Fary</u> Joseph F. Fary	Director	March 28, 2008
<u>/s/ William D. Fary</u> William D. Fary	Director	March 28, 2008

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31.2	Rule 13a-14(a) Certification of Chief Financial Officer
32.1	Statement of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. § 1350

Rule 13a-14(a) Certification of Chief Executive Officer

I, William J. Farinholt, certify that:

1. I have reviewed this annual report on Form 10-KSB of Colonial Virginia Bank for the year ended December 31, 2007;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the small business issuer and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurances regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - (d) Disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and

5. The small business issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: March 28, 2008

/s/ William J. Farinholt
William J. Farinholt
Chief Executive Officer

Rule 13a-14(a) Certification of Chief Financial Officer

I, Kenneth E. Smith, certify that:

1. I have reviewed this annual report on Form 10-KSB of Colonial Virginia Bank for the year ended December 31, 2007;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the small business issuer as of, and for, the periods presented in this report;
4. The small business issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act rules 13a-15(f) and 15d-15(f)) for the small business issuer and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the small business issuer, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurances regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the small business issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - (d) Disclosed in this report any change in the small business issuer's internal control over financial reporting that occurred during the small business issuer's most recent fiscal quarter (the small business issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the small business issuer's internal control over financial reporting; and

5. The small business issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the small business issuer's auditors and the audit committee of the small business issuer's board of directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the small business issuer's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the small business issuer's internal control over financial reporting.

Date: March 28, 2008

/s/ Kenneth E. Smith
Kenneth E. Smith
Chief Financial Officer

Statement of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. § 1350

In connection with the Annual Report on Form 10-KSB for the year ended December 31, 2007 (the "Form 10-KSB") of Colonial Virginia Bank (the "Bank"), we, William J. Farinholt, Chief Executive Officer of the Bank, and Kenneth E. Smith, Chief Financial Officer of the Bank, hereby certify pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to our knowledge:

- (a) the Form 10-KSB fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended; and
- (b) the information contained in the Form 10-KSB fairly presents, in all material respects, the financial condition and results of operations of the Bank as of and for the periods presented in the Form 10-KSB.

By: /s/ William J. Farinholt
William J. Farinholt
Chief Executive Officer

Date: March 28, 2008

By: /s/ Kenneth E. Smith
Kenneth E. Smith
Chief Financial Officer

Date: March 28, 2008