

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

FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2010

or

Transition Report pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COLONIAL VIRGINIA BANK

(Exact name of registrant as specified in its charter)

Virginia

(State or other jurisdiction of  
incorporation or organization)

75-3093106

(IRS Employer  
Identification No.)

6720 Sutton Road  
Gloucester, Virginia

(Address of principal executive offices)

23061

(Zip Code)

(804) 695-9300

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

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

610,175 shares of common stock, par value \$5.00 per share,  
outstanding as of May 14, 2010

# COLONIAL VIRGINIA BANK

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## PART I. FINANCIAL INFORMATION

### Item 1. FINANCIAL STATEMENTS

#### COLONIAL VIRGINIA BANK Balance Sheets

	<u>(unaudited)</u> March 31,	<u>(audited)</u> December 31,
	<u>2010</u>	<u>2009</u>
<b>Assets:</b>		
Cash and due from banks	\$ 5,585,411	\$ 6,883,051
Federal funds sold	1,706,000	6,699,000
Securities available for sale, at fair market value	34,385,232	35,679,122
Securities held to maturity (fair market value of \$342,888 in 2010 and \$371,940 in 2009)	320,981	350,536
Restricted securities, at cost	989,950	998,650
Loans, net of allowance for loan losses of \$1,085,641 in 2010 and \$1,029,400 in 2009	69,455,212	65,145,113
Bank premises and equipment, net	4,780,207	4,831,848
Bank owned life insurance	2,795,193	2,760,693
Other assets	<u>1,845,510</u>	<u>1,982,494</u>
 Total assets	 <u>\$ 121,863,696</u>	 <u>\$ 125,330,507</u>
 <b>Liabilities and Shareholders' Equity:</b>		
Liabilities:		
Deposits:		
Non-interest bearing demand deposits	\$ 7,296,875	\$ 9,729,133
Savings and interest bearing demand deposits	36,067,427	34,655,977
Time deposits	<u>57,672,685</u>	<u>61,477,487</u>
Total deposits	\$ 101,036,987	\$ 105,862,597
 Federal Home Loan Bank borrowings	 7,500,000	 6,500,000
Accrued expenses and other liabilities	<u>1,412,523</u>	<u>1,320,101</u>
Total liabilities	<u>\$ 109,949,510</u>	<u>\$ 113,682,698</u>
 Shareholders' Equity:		
Preferred stock, par value \$5.00 per share, authorized 5,000,000 shares; no shares issued and outstanding	\$ -	\$ -
Common stock, par value \$5.00 per share, authorized 10,000,000 shares; issued and outstanding 610,175 shares	3,050,875	3,050,875
Capital surplus	9,139,425	9,139,425
Retained (deficit)	(767,953)	(889,309)
Accumulated other comprehensive income, net	<u>491,839</u>	<u>346,818</u>
Total shareholders' equity	<u>\$ 11,914,186</u>	<u>\$ 11,647,809</u>
 Total liabilities and shareholders' equity	 <u>\$ 121,863,696</u>	 <u>\$ 125,330,507</u>

See Accompanying Notes to Financial Statements.

**COLONIAL VIRGINIA BANK**  
**Statements of Income**

(Unaudited)

	<b>Three Months Ended March 31, 2010</b>	<b>Three Months Ended March 31, 2009</b>
<b>Interest and Dividend Income</b>		
Interest and fees on loans	\$1,197,474	\$1,142,614
Interest on securities		
Taxable	358,622	351,199
Tax exempt interest income	3,263	1,994
Dividends	5,786	4,718
Interest on federal funds sold and other	1,354	4,254
Total interest income	<u>\$1,566,499</u>	<u>\$1,504,779</u>
<b>Interest Expense</b>		
Interest on deposits	\$423,005	\$599,427
Interest on short-term borrowings	35,959	45,621
Total interest expense	<u>\$458,964</u>	<u>\$645,048</u>
Net interest income	\$1,107,535	\$859,731
<b>Provision for Loan Losses</b>	<u>66,050</u>	<u>41,050</u>
Net interest income after provision for loan losses	<u>\$1,041,485</u>	<u>\$818,681</u>
<b>Other Income</b>		
Service charges on deposit accounts	\$31,004	\$25,768
Income on bank owned life insurance	34,500	46,581
Net gain on securities	4,512	5,244
Other service charges, commissions and fees	37,579	22,100
Total other income	<u>\$107,595</u>	<u>\$99,693</u>
<b>Other Expense</b>		
Salaries and employee benefits	\$558,021	\$460,858
Occupancy expense	64,403	47,180
Furniture and equipment expense	26,085	22,016
Data processing	117,389	120,539
Advertising	26,811	25,035
Professional fees	49,794	49,571
Stationery and supplies	12,217	13,951
Postage and freight	11,451	8,568
Regulatory assessments	50,581	23,374
Insurance	10,496	10,145
Franchise tax	17,332	18,296
Directors fees	17,000	16,800
Other operating expenses	25,944	44,493
Total other expense	<u>\$987,524</u>	<u>\$860,826</u>
Net Income before income taxes	\$161,556	\$57,548
Income taxes	40,200	3,700
Net Income	<u>\$121,356</u>	<u>\$53,848</u>
Earnings per share, basic and diluted	\$0.20	\$0.09
Weighted Average Shares Outstanding, basic	610,175	610,175
Weighted Average Shares Outstanding, diluted	610,175	610,351

See Accompanying Notes to Financial Statements.

**COLONIAL VIRGINIA BANK**  
**Statements of Changes in Shareholders' Equity**  
**For the Three Months Ended March 31, 2010**  
**and March 31, 2009 (Unaudited)**

	<u>Common Stock</u>	<u>Capital Surplus</u>	<u>Retained (Deficit)</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Comprehensive Income</u>	<u>Total</u>
<b>Balance at December 31, 2008</b>	\$ 3,050,875	\$ 9,132,538	\$ (589,350)	\$ 307,708		\$ 11,901,771
Comprehensive income:						
Net income	--	--	53,848	--	\$ 53,848	53,848
Other comprehensive income,						
Change in unrealized gain on securities available for sale, net of taxes	--	--	--	--	46,461	
Reclassification adjustment, net of taxes	--	--	--	--	(3,461)	
Change in pension liability	--	--	--	--	(5,243)	
Other comprehensive income	--	--	--	37,757	<u>\$ 37,757</u>	37,757
Total comprehensive income	--	--	--	--	<u>\$ 91,605</u>	
Stock based compensation	--	2,296	--	--		2,296
<b>Balance at March 31, 2009</b>	<u>\$ 3,050,875</u>	<u>\$ 9,134,834</u>	<u>\$ (535,502)</u>	<u>\$ 345,465</u>		<u>\$ 11,995,672</u>
<b>Balance at December 31, 2009</b>	\$ 3,050,875	\$ 9,139,425	\$ (889,309)	\$ 346,818		\$ 11,647,809
Comprehensive income:						
Net income	--	--	121,356	--	\$ 121,356	121,356
Other comprehensive income,						
Change in unrealized gain on securities available for sale, net of taxes	--	--	--	--	143,058	
Reclassification adjustment, net of taxes	--	--	--	--	(2,978)	
Change in pension liability	--	--	--	--	4,941	
Other comprehensive income	--	--	--	145,021	<u>\$ 145,021</u>	145,021
Total comprehensive income	--	--	--	--	<u>\$ 266,377</u>	
<b>Balance at March 31, 2010</b>	<u>\$ 3,050,875</u>	<u>\$ 9,139,425</u>	<u>\$ (767,953)</u>	<u>\$ 491,839</u>		<u>\$ 11,914,186</u>

See Accompanying Notes to Financial Statements.

**COLONIAL VIRGINIA BANK**  
**Statements of Cash Flows**  
**For the Three Months Ended March 31, 2010**  
**and March 31, 2009 (Unaudited)**

<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	2010	2009
Reconciliation of net income to net cash provided by operating activities:		
Net income	\$ 121,356	\$ 53,848
Net amortization on investment securities	23,223	2,164
Depreciation and amortization	68,124	60,974
Provision for loan losses	66,050	41,050
Stock-based compensation	-	2,296
(Gain) on securities	(4,512)	(5,244)
Changes in assets and liabilities:		
Decrease (increase) in accrued interest and other assets	69,761	(67,928)
Increase in accrued expenses and other liabilities	92,422	107,358
Net cash provided by operating activities	\$ 436,424	\$ 194,518
 <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
(Purchase) of securities available for sale	\$ (5,028,178)	\$ (8,134,374)
Principal paydowns of securities	1,890,156	1,238,425
Proceeds from calls and maturities of securities available for sale	4,655,000	2,027,466
Proceeds from calls and maturities of securities held to maturity	-	300,000
Cancellation of Federal Reserve Stock	8,700	-
(Purchase) of Federal Home Loan Bank Stock	-	(27,500)
Net (increase) in loans	(4,376,149)	(2,915,625)
(Increase) in bank owned life insurance	(34,500)	(45,204)
(Purchase) of premises and equipment	(16,483)	(309,524)
Net cash (used in) investing activities	\$ (2,901,454)	\$ (7,866,336)
 <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase (decrease) in demand, savings, interest-bearing checking and money market deposits	\$ (1,020,808)	\$ 577,136
Net increase (decrease) in time deposits	(3,804,802)	2,006,516
Net increase (decrease) in other borrowings	1,000,000	(2,500,000)
Net cash provided by (used in) financing activities	\$ (3,825,610)	\$ 83,652
 Net (decrease) in cash and cash equivalents	\$ (6,290,640)	\$ (7,588,166)
 <b>CASH AND CASH EQUIVALENTS</b>		
Beginning	\$ 13,582,051	\$ 13,941,510
Ending	\$ 7,291,411	\$ 6,353,344
 <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid for interest	\$ 503,376	\$ 647,186
Cash paid for income taxes	\$ 67,089	\$ -
 <b>SUPPLEMENTAL DISCLOSURE OF NONCASH ACTIVITIES</b>		
Unrealized gain on securities available for sale	\$ 212,244	\$ 65,152
Change in pension liability	\$ 4,941	\$ (5,243)

See Accompanying Notes to Financial Statements.

**COLONIAL VIRGINIA BANK**  
**Notes to Financial Statements**  
For the Three Months Ended March 31, 2010  
and March 31, 2009 (Unaudited)

**Note 1. General**

Colonial Virginia Bank (the Bank) was organized under the laws of the Commonwealth of Virginia to engage in a general banking business serving the community in and around Gloucester County, Virginia. The Bank is a member of the Federal Reserve System and the Federal Deposit Insurance Corporation. It is subject to the regulations of the Federal Reserve System and the State Corporation Commission of Virginia. Consequently, it undergoes periodic examinations by these regulatory authorities.

In the opinion of management, the accompanying unaudited financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Bank's financial position at March 31, 2010, the statements of operations for the three months ended March 31, 2010, and the changes in shareholders' equity and cash flows for the three months ended March 31, 2010. Financial statements are prepared in accordance with generally accepted accounting principles. Operating results for the three month period ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. The statements should be read in conjunction with the Notes to Financial Statements included in the Bank's Annual Report on Form 10-K for the year ended December 31, 2009, as filed with the Federal Reserve System.

**Note 2. Securities**

Amortized cost and fair values of securities available for sale at March 31, 2010, were as follows:

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>	<b>Fair Value</b>
U.S. Treasury securities	\$ 1,006,546	\$ -	\$ (12,716)	\$ 993,830
Securities of U.S. government and federal agencies	13,073,041	174,379	(25,803)	13,221,617
Mortgage backed securities	18,547,564	717,329	(15,662)	19,249,231
Securities of states and political subdivisions	899,258	21,692	(396)	920,554
Total	<u>\$ 33,526,409</u>	<u>\$ 913,400</u>	<u>\$ (54,577)</u>	<u>\$ 34,385,232</u>

Amortized cost and fair values of securities held to maturity at March 31, 2010, were as follows:

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>	<b>Fair Value</b>
Mortgage backed securities	\$ 320,981	\$ 21,907	\$ -	\$ 342,888
Total	<u>\$ 320,981</u>	<u>\$ 21,907</u>	<u>\$ -</u>	<u>\$ 342,888</u>

Amortized cost and fair values of securities available for sale at December 31, 2009, were as follows:

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>	<b>Fair Value</b>
Securities of U.S. government and federal agencies	\$ 8,334,364	\$ -	\$ (152,329)	\$ 8,182,035
Mortgage backed securities	25,999,132	829,093	(53,051)	26,775,174
Securities of states and political subdivisions	699,047	22,866	-	721,913
Total	<u>\$ 35,032,543</u>	<u>\$ 851,959</u>	<u>\$ (205,380)</u>	<u>\$ 35,679,122</u>

Amortized cost and fair values of securities held to maturity at December 31, 2009, were as follows:

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized (Losses)</b>	<b>Fair Value</b>
Mortgage backed securities	\$ 350,536	\$ 21,404	\$ -	371,940
Total	<u>\$ 350,536</u>	<u>\$ 21,404</u>	<u>\$ -</u>	<u>\$ 371,940</u>

At March 31, 2010 and December 31, 2009, approximately \$100,000 of securities were pledged to secure deposits of the Commonwealth of Virginia. At March 31, 2010 and December 31, 2009, approximately \$8,601,340 and \$9,159,294 of securities were pledged, respectively, to secure advances at the Federal Home Loan Bank.

For the three months ended March 31, 2010 and 2009, proceeds from calls of securities available for sale totaled \$4,655,000 and \$2,000,000, respectively. There were no sales of securities available for sale for the three months ended March 31, 2010 and 2009, respectively.

There were no calls of securities held to maturity for the three months ended March 31, 2010 and 2009, respectively.

At March 31, 2010, 10 investment securities had an unrealized loss. The investment securities are obligations of entities that are excellent credit risks. The temporary impairment noted is the result of market conditions and does not reflect on the ability of the issuers to repay the obligations. These 10 securities had a total unrealized loss of \$54,577 and a market value of \$6,530,786 at March 31, 2010. There were 2 investment securities held at March 31, 2010 that had been in an unrealized loss position for greater than 12 months. These 2 securities had a total unrealized loss of \$14,369 and a market value of \$1,418,947 at March 31, 2010. The remaining 8 securities had a total unrealized loss of \$40,208 and a market value of \$5,111,839 at March 31, 2010. The Bank does not intend to sell the investments and it is not more likely than not that the Bank will be required to sell the investments before recovery of their amortized cost bases.

<b>March 31, 2010</b>	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
<u>Description of Securities</u>	<u>Fair Value</u>	<u>Unrealized (Losses)</u>	<u>Fair Value</u>	<u>Unrealized (Losses)</u>	<u>Fair Value</u>	<u>Unrealized (Losses)</u>
U. S. Treasury securities	\$ 993,830	(\$ 12,716)	\$ --	\$ --	\$ 993,830	(\$ 12,716)
Securities of U.S. government and federal agencies	1,328,052	(19,937)	680,556	(5,866)	2,008,608	( 25,803)
Mortgage backed securities	2,590,211	(7,159)	738,391	(8,503)	3,328,602	( 15,662)
Securities of states and political subdivisions	199,746	(396)	--	--	199,746	(396)
Total temporarily impaired securities	<u>\$ 5,111,839</u>	<u>(\$40,208)</u>	<u>\$1,418,947</u>	<u>\$ (14,369)</u>	<u>\$6,530,786</u>	<u>(\$54,577)</u>

  

<b>December 31, 2009</b>	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
<u>Description of Securities</u>	<u>Fair Value</u>	<u>Unrealized (Losses)</u>	<u>Fair Value</u>	<u>Unrealized (Losses)</u>	<u>Fair Value</u>	<u>Unrealized (Losses)</u>
Securities of U.S. government and federal agencies	\$6,185,750	(\$152,329)	\$ --	\$ --	\$6,185,750	(\$152,329)
Mortgage backed securities	3,421,195	(53,051)	--	--	3,421,195	(53,051)
Total temporarily impaired securities	<u>\$9,606,945</u>	<u>(\$205,380)</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$9,606,945</u>	<u>(\$205,380)</u>

### **Note 3. Loans**

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

	<u>March 31, 2010</u>	<u>December 31, 2009</u>
Mortgage:		
Construction and land development	\$ 12,482,420	\$ 12,622,629
Residential real estate	25,285,425	22,979,969
Nonresidential	16,030,414	14,292,963
Commercial	10,591,025	10,269,654
Agricultural and Other Farm Loans	239,000	408,000
Consumer and All Other Loans	6,073,216	5,748,752
	<u>70,701,500</u>	<u>66,321,967</u>
Unearned income	160,647	147,454
Allowance for loan losses	1,085,641	1,029,400
Loans, net	<u>\$ 69,455,212</u>	<u>\$ 65,145,113</u>

Overdrafts totaling \$13,786 and \$45,228 at March 31, 2010 and December 31, 2009, respectively, were reclassified from deposits to loans.

Non-performing assets totaled \$460,201 and \$226,421 at March 31, 2010 and December 31, 2009, respectively.

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

	<b>March 31, 2010</b>	<b>December 31, 2009</b>	<b>March 31, 2009</b>
Balance at the beginning of the period (January 1)	\$ 1,029,400	\$ 622,068	\$ 622,068
Provision for loan losses	66,050	730,200	41,050
Loans charged off	(16,707)	(325,202)	(38,984)
Recoveries on loans previously charged off	6,898	2,334	1,443
Balance at the end of the period	<u>\$ 1,085,641</u>	<u>\$ 1,029,400</u>	<u>\$ 625,577</u>

**Note 4. Earnings Per Share**

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

	Three months ended March 31, 2010		Three months ended March 31, 2009	
	Shares	Amount	Shares	Amount
Basic loss per share	610,175	\$ 0.20	610,175	\$ 0.09
Effect of dilutive securities:				
Stock Options	-		176	
Diluted loss per share	<u>610,175</u>	\$ 0.20	<u>610,351</u>	\$ 0.09

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 reflect additional common shares that would have been outstanding if potential dilutive common shares had been issued, as well as any adjustment to income that would result from issuance. For the three month period ended March 31, 2010, stock options representing 34,604 potential shares were excluded from the calculation of diluted earnings per share as their effect would have been anti-dilutive.

**Note 5. Stock Based Compensation**

As of March 31, 2010, the Bank had a stock based compensation plan. Compensation expense is recorded for all awards granted.

The fair value of each grant is estimated at the grant date using the Black-Scholes option-pricing model. There were no options granted in the three month periods ended March 31, 2010 and 2009, respectively. There were no options exercised in the three month periods ended March 31, 2010 and 2009, respectively.

The following summarizes the stock option activity for the three month period ended March 31, 2010:

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term</u>	<u>Intrinsic Value of Unexercised In-the-Money Options (1)</u>
Options outstanding, January 1, 2010	34,604	\$ 20.81		
Granted	-	-		
Exercised	-	-		
Forfeited	-	-		
Options outstanding, March 31, 2010	<u>34,604</u>	<u>\$ 20.81</u>	4.71	
Options exercisable, March 31, 2010	<u>34,604</u>	<u>\$ 20.81</u>	4.71	\$ --

(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 March 31, 2010. This amount changes based on changes in the market value of the Bank's stock.

## **Item 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis of the financial condition and results of operations of the Bank for the three months ended March 31, 2010 should be read in conjunction with the Bank’s Financial Statements and the accompanying Notes to Financial Statements included in this report and in the Bank’s Annual Report on Form 10-K for the year ended December 31, 2009 (the “2009 Form 10-K”).

### **Executive Overview**

The Bank is headquartered in Gloucester, Virginia. The Bank is a community bank principally serving the Virginia counties of Gloucester and New Kent, but also providing banking services in the overall market known as the Middle Peninsula of Virginia, as well as the Peninsula of Virginia. The Bank also has an investment division operating under the name of Colonial Virginia Investment Services. The Bank offers various mortgage products through both banking offices under the name of Colonial Virginia Mortgage, LLC (“CVM”). This entity is structured as a 50-50 joint venture with Johnson Mortgage Company, LLC (“JMC”). JMC is located in Newport News, Virginia.

The Bank’s results of operations are primarily dependent on net interest income, which is the difference between the income earned on our loans and investment portfolio and the cost of funds, consisting of the interest paid on deposits and borrowings. Results of operations are also affected by our allowance for loan losses, investment activities and other fees. Non-interest expense principally consists of salary 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 materially different financial condition or results of operations is a reasonable likelihood.

#### *Allowance for Loan Losses*

The Bank monitors and maintains an allowance for loan losses 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 evaluates various loans individually for impairment. 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 potential loss 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. 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 or too low. 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. Further discussion of the adequacy and analysis of the level of the allowance for loan losses is included below.

## **Financial Summary**

Net income for the three month period ended March 31, 2010 was \$121,356, or \$0.20 per share assuming dilution, compared to net income of \$53,848 for the three month period ended March 31, 2009, or \$.09 per share assuming dilution. The Bank continues to enjoy the lower and level interest rate environment allowing for downward re-pricing of higher cost, longer term certificates of deposit (“CDs”), decreasing its overall cost of funds. The average rate on interest-bearing liabilities during the first quarter 2010 was 1.82%, a significant reduction from an average rate of 2.83% for the same period last year.

The provision for possible loan loss expense was \$66,050 for the three month period ended March 31, 2010, compared to \$41,050 for the same period in 2009. The Bank provides for potential future loan losses (charge-offs) through the allowance for loan and lease losses (“ALLL”). This reserve is created through the provision for loan losses. A major factor in this increase was the effect of the continuing recessionary economic conditions, nationally, statewide and locally. As an example, according to the Bureau of Labor Statistics, unemployment rates for Gloucester, Mathews, Middlesex and New Kent Counties (the Bank’s primary market area) were 7.1%, 7.0%, 8.5% and 8.5%, respectively as of March 2010, compared to 5.9%, 5.4%, 6.8% and 6.9%, respectively in December 2009. These numbers have reflected steady increases over the past two years, but the rate of increase has begun to

slow. Housing starts and building permits have reflected similar declining trends. Housing permits through February 2010 in the Gloucester market, however, have indicated an annualized level comparable to 2009, indicating a possible cessation of the declining trend. In this same analysis, the Bank has maintained its previous reserve levels for unsecured credit, typically underwritten for only its best borrowers. However, even these borrowers are experiencing the effects of the troubled economy, and thus, a more aggressive reserve is considered prudent. Additionally, banking regulatory authorities are strongly encouraging all banks to bolster their balances in the ALLL. Therefore, in anticipation that the worst of the recession might not have been realized yet, the Bank expects to continue to experience increased expenses associated with building a larger ALLL. It should also be noted that the Bank, having been a de novo bank in November 2003, has now begun to use its own loan loss experience in conjunction with peer group banks to determine an appropriate reserve balance. Identifying its own charge-off loss experiences, the current ALLL is considered to be at a prudent level.

For the three month period ended March 31, 2010, gross revenues, which are defined as interest income plus other income, were \$1.7 million compared to \$1.6 million for the three month period ended March 31, 2009. Gross expenses, which are defined as interest expense plus other expenses, the provision for loan losses and the provision for income taxes, were \$1.6 million for the three month period ended March 31, 2010, resulting in net income of \$121,356. Comparatively, gross expenses for the three month period ended March 31, 2009 totaled \$1.6 million resulting in net income of \$53,848. Total average assets increased 9.5% from \$111.2 million for the three months ended March 31, 2009 to \$121.8 million for the three months ended March 31, 2010. Average shareholders' equity decreased 0.8% from \$11.9 million for the three months ended March 31, 2009 to \$11.8 million for the three months ended March 31, 2010. Annualized return on average assets for the three months ended March 31, 2010 and March 31, 2009 was 0.40% and 0.20%, respectively. Annualized return on average equity for the three months ended March 31, 2010 and March 31, 2009 was 4.16% and 1.84%, respectively.

Total assets for the Bank totaled \$121.9 million at March 31, 2010, compared to \$125.3 million at December 31, 2009, representing a decrease of \$3.4 million or 2.7%. Total net loans at March 31, 2010 were \$69.5 million, an increase of \$4.4 million, or 6.8%, from the December 31, 2009 amount of \$65.1 million. While greater growth potentially could occur, the Bank's philosophy has been to not compromise its underwriting standards and sound credit quality for the sake of growth, in order to foster stable earnings without the interruption of unexpected loan losses. The ALLL totaled \$1,085,641, or 1.54% of total loans outstanding, at March 31, 2010. The methodology for assessing the adequacy of the ALLL is discussed elsewhere in this report.

The investment portfolio decreased 3.6% to \$34.7 million at March 31, 2010 compared to \$36.0 million at December 31, 2009. Management continues to believe that yields in the loan portfolio are preferable to general investment yields within the bond market. General yields within the bond market have declined slightly. As market yields have declined and prices increased, the Bank's level of unrealized gains in the portfolio enhance the Bank's flexibility to sell bonds, if necessary, for liquidity purposes. Management, however, continues a general philosophy of selling bonds only on a selective basis. The levels of interest rate risk and market risk are considered manageable relative to overall balance sheet management.

Deposits decreased \$4.9 million (4.6%) to \$101.0 million at March 31, 2010 from \$105.9 million at December 31, 2009. Time deposits totaled \$57.7 million at March 31, 2010, a decrease of \$3.8 million (6.2%) from \$105.9 million at December 31, 2009. Management has purposely controlled deposit growth due to continued pressure on retail CD pricing from some larger financial institutions which are suffering liquidity stresses. The costs of some of these higher priced CDs would compress the net interest margin to an unacceptable level. Therefore, the Bank has become more selective in matching competing rates in its local market, especially in circumstances where the depositor maintains no extended relationship with

the Bank except for volatile rate-sensitive CDs. The Bank did hold its rates steady on interest bearing demand deposits (“NOW”), savings and Money Market accounts (“MMA”) during the general decline of market rates. This created a modest competitive advantage, although the overall cost was lower than higher interest CDs. The Bank has implemented minimal rate decreases in the NOW, Savings and MMA accounts during the past six months. Savings, NOW and MMA deposits increased \$1.4 million (4.0%), totaling \$36.1 million March 31, 2010 compared to \$34.7 million December 31, 2009. The increase in MMAs is considered to be a result of the customer mindset of holding funds in a more liquid account, anticipating a rising interest rate environment in the near future. This may result in a shift from MMAs to CDs if rates do, in fact, begin to rise. Management expects to continue to avoid growth for the sake of growth, unless pricing decisions on increased funding sources can reasonably result in use of those funds at an appropriate interest spread.

Shareholders’ equity totaled \$11,914,186 at March 31, 2010. This amount represents an increase of 2.3% from the December 31, 2009 amount of \$11,647,809. Average shareholders’ equity decreased 0.1% from \$11.9 million for the year ended December 31, 2009 to \$11.8 million for the three months ended March 31, 2010. The March 31, 2010 figure reflects the \$121,356 net income plus a \$145,022 increase in other comprehensive income, including the unrealized gains on securities available for sale and the Supplemental Executive Retirement Plan (“SERP”) adjustment. The book value per common share was \$19.53 at March 31, 2010 and \$19.09 at December 31, 2009.

### **Net Interest Income**

Net interest income for the three month period ended March 31, 2010 totaled \$1,107,535, representing an increase of \$247,804 (28.8%) over the same period in 2009. Average earning assets increased \$7.1 million from \$101.5 million for the first three months of 2009 to \$108.6 million for the first three months of 2010. Average interest bearing liabilities increased \$9.8 million from \$91.3 million for the first three months of 2009 to \$101.1 million for the first three months of 2010. The net interest margin (net interest income expressed as a percentage of average earning assets) (“NIM”) was 4.09% for the three months ended March 31, 2010 compared to 3.39% for the three months ended March 31, 2009.

The Bank has historically relied heavily on fixed rate consumer CDs for the majority of its funding. Many of these CDs have maturities of 13 to 17 months, thus restricting the Bank’s ability to quickly reduce rates paid, even in an environment of declining rates, such as we experienced in 2008. As mentioned above, the prolonged lower level rate environment has afforded the Bank the ability to reduce its overall cost of funds, while not experiencing continued reduction of asset yields. Efforts are underway to reduce reliance on these fixed rate funds and more closely tie the repricing of variable rate assets to their respective variable rate funding sources. Re-pricing over the past three to six months has helped better match cost of funds to asset yields. During the first quarter of 2010, the Bank renewed approximately \$9.4 million in CDs at an average rate of 1.5%, compared to a rate of 3.2% for these CDs prior to maturity. Evidence of the Bank’s discipline in this cost of funds reduction effort is that approximately \$5.4 million of renewing CDs during this time period was allowed to be redeemed versus paying premium rates requested by customers holding these deposits. Some were converted to lower cost MMAs, while others were simply redeemed. The Bank’s practice of flooring variable rate loans (contractually limiting how much the individual loan rate can decrease regardless of decreases in market rates), which was begun in the fourth quarter 2009, has mitigated the sharp decreases in market rates in 2008. In the face of the current Prime rate of 3.25%, the Bank has altered its use of “Prime” as a pricing index, specifically the variance between Prime and the individual loan’s contract rate. Where a loan might have historically been priced at Prime plus 0.50% or Prime plus 1.00%, similar loans are being priced at Prime plus 2.25% to Prime plus 3.50%, with rate floors at the original rate.

Loan demand has remained stable during the most recent quarter, despite the vast publicity of the weakening economy, which bodes well for overall improving yields on average earning assets. However, because of the weakened economy, pricing for the best quality loans has become increasingly competitive in the Bank's market. The Bank has maintained its strategic decision to manage liquidity in a more balanced fashion through alternative funding sources such as the Federal Home Loan Bank of Atlanta ("FHLB"), not relying completely on excess levels of asset liquidity in the form of overnight Fed funds sales. Additionally, brokered CDs continue to provide an economically priced and efficient source of liquidity.

The Bank utilizes asset liability management ("ALM") modeling software to aid in the identification and management of interest rate risk. This software provides tools for identifying re-pricing 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 may 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.

Due to the flooring of loan rates, discussed above, the Bank's balance sheet structure has evolved into a moderately liability sensitive condition since some loans are at current floored rates substantially above market levels. Therefore, market rates would need to rise before they would increase again. However, if market rates begin to increase only slightly, deposit liability rates could increase before assets yields increase.

### **Non-interest Income**

The primary components of non-interest income include service charges on deposit accounts, ATM transaction fees, commissions on credit life insurance, checkbook sales, title insurance, investment services income, mortgage division income and net gains on securities. Included in the deposit fee income are fees for overdrafts and non-sufficient funds return items on checking accounts. The current consumer regulation reform environment includes certain potential restrictions (ultimately reductions) on fees charged for overdrafts under "overdraft protection" programs offered by many banks. In these programs, customers enjoy the privilege of knowing that their overdrafts will always be paid up to a certain pre-determined amount. The Bank does not offer such a program; thus, each overdraft is considered for final payment or possible return of the check as non-sufficient funds (for which the Bank charges fees per item considered). The Bank does not anticipate that the new regulations will pose a risk of significant reduction in its historical fee level for these services. For the three month period ended March 31, 2010, non-interest income of \$107,595 represented an increase of \$7,902 (7.9%) over the three month period ended March 31, 2009.

For the three months ended March 31, 2010, investment services income totaled \$13,095 compared to \$3,313 for the three months ended March 31, 2009. There are modest signs that consumers are participating in the improving stock market by increasing their trading activity. The Bank's mortgage services division, CVM, experienced a loss of \$6,061 in the first three months of 2010, compared to a loss of \$7,060 in the first three months of 2009. Although refinance activity has begun to increase, mortgage activity generally has been slower due to overall weaker economic conditions and reduced home sales.

### **Non-interest Expense**

Non-interest expense for the three month period ended March 31, 2010 totaled \$987,524 compared to \$860,826 for the three month period ended March 31, 2009. Several factors contributed to the increase. First, the Bank experienced an increase in salaries and employee benefits expense of

\$97,163 for the three month period ended March 31, 2010, due to the hiring of a Compliance Officer and additional staff for the New Kent branch office. Second, the FDIC assessment increased \$26,481 for the three months ended March 31, 2010, compared to the same period in 2009, due to an increase in the assessment calculation by the FDIC. The provision for income taxes totaled \$40,200 in the first quarter 2010 compared to \$3,700 in the first quarter 2009.

### **Non-GAAP Financial Measure**

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 Management believes provides important information about the Bank's 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 the Bank matures, an efficiency ratio of 60% to 65% is targeted. For the three months ended March 31, 2010, the Bank's efficiency ratio was 81.46% compared to 90.12% at March 31, 2009.

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 \$3.4 million per employee at March 31, 2010 and \$4.1 million per employee at March 31, 2009.

### **Allowance for Loan Losses**

The allowance for loan losses at March 31, 2010 was \$1,085,641, compared to \$1,029,400 at December 31, 2009. The allowance for loan losses was 1.54% of total loans outstanding at March 31, 2010, compared to 1.55% at December 31, 2009. The provision for loan losses was \$66,050 for the three month period ended March 31, 2010, compared to \$41,050 for the same period in 2009. The provision for loan 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 loan 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 Allowance for Loan and Lease Losses ("ALLL"). Asset quality is considered satisfactory. As of March 31, 2010, the Bank had no foreclosed properties and two repossessed properties totaling \$86,783, compared to no foreclosed properties and one repossessed property totaling \$5,105 at March 31, 2009. Nonaccrual loans totaled \$373,418 at March 31, 2010, compared to \$59,994 at March 31, 2009. Loans past due 90 days or more and still accruing interest at the end of the first quarter 2010 totaled \$496,319, compared to \$231,246 at the end of the first quarter 2009. As discussed above, the struggling economy mandates that management establish and maintain a solid ALLL. Management believes that the ALLL is adequate to cover credit losses inherent in the loan portfolio at March 31, 2010. The Bank does not engage in "sub-prime lending."

Management uses a risk-rating system that includes six "pass" (or acceptable) grades, as well as four adverse grades. All loans are evaluated and assigned a risk rating at the time the loan is made. Periodic subsequent review assesses the loan's performance as well as changes in the borrower's financial condition. Management incorporates these ratings into its methodology for evaluating the adequacy of the ALLL, as well as its pricing strategies. The methodology was developed as a part of management's compliance with applicable accounting requirements, discussed above in "Critical Accounting Policies." Those loans with whom the borrower's financial condition has deteriorated to a level that results in an adverse risk rating are evaluated individually for impairment. This evaluation is performed monthly and incorporated into the ALLL adequacy analysis, reflecting any respective loss potential for each loan. The

methodology also incorporates factors associated with general economic conditions within the Bank's market, such as employment statistics, housing starts, and building permits. Another element incorporates a potential loss factor for concentrations of credit, such as unsecured loans. Although the Bank only extends unsecured credit to its highest rated customers, any unforeseen reversals experienced by a borrower with unsecured credit could result in a higher risk of potential loss. Although the ALLL methodology is designed to comply with GAAP standards, the current banking regulatory environment has a "safety and soundness" focus that has refocused on the ALLL's general relationship to total loans outstanding.

## **Capital Resources**

Shareholders' equity at March 31, 2010 totaled \$11,914,186 compared to \$11,647,809 at December 31, 2009. Total common shares outstanding at March 31, 2010 were 610,175.

At March 31, 2010, the Bank's tier 1 and total risk-based capital ratios were 13.93% and 15.01%, respectively, compared to 14.09% and 15.16% at December 31, 2009. The Bank's leverage ratio was 9.38% at March 31, 2010, compared to 9.13% at December 31, 2009. The Bank has deliberately controlled, even restricted, growth of the balance sheet through disciplined deposit pricing (discussed elsewhere in this report), which has protected and enhanced the overall leverage position relative to 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 volatile economic conditions, such as the lingering recession plaguing the entire country, as well as the local region in which the Bank operates. There has been an implied message from regulatory authorities that capital standards may be increased in light of the many banks that have not been able to withstand the vagaries of the recent and continuing recessionary pressures. The Bank is positioned for moderate growth of the balance sheet at current capital levels. However, should minimum capital requirements be increased, the Bank may be forced to raise additional capital in the open market. The current market environment reflects the majority of community banks' stock is trading at a level below book value (total stockholders' equity divided by the total number of shares outstanding). Therefore, it is not advantageous to existing stockholders to have a public offering at an offering price below book value, although regulatory pressure may require the additional capital in order to grow the Bank.

## **Liquidity**

Liquidity represents an institution's ability to meet present and future financial obligations through either the sale or maturity of existing assets or the acquisition of additional funds through liability management. Liquid assets include cash, interest-bearing deposits with banks, federal funds sold, short-term investments, securities classified as available for sale and loans and securities maturing within one year. As a result of the Bank's management of liquid assets and the ability to generate liquidity through liability funding, management believes that the Bank maintains overall liquidity sufficient to satisfy its depositors' requirements and meet its customers' credit needs.

At March 31, 2010, cash, interest-bearing deposits with financial institutions, federal funds sold and securities available for sale were 34.6% of total deposits and liabilities. Management, through 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 Fed funds and other cash equivalents, market value of securities available for sale, and unused lines of credit) as a percentage of total assets. The policy requires that this ratio be equal to or greater than 15% of total assets. At March 31, 2010, this ratio was 38.1%. This excess, however, is skewed somewhat in that it includes all AFS securities. Some of these securities (identified

as AFS) experience fluctuations in market values based on interest rate trends and as of the end of the current quarter reflected a net unrealized gain of \$566,823, compared to a net unrealized gain of \$440,212 at March 31, 2009. Thus, they could not only be considered candidates to be sold to generate liquidity through their principal proceeds, but also contribute substantial additional income to the Bank's profit and loss picture. Some of these securities are amortizing mortgage backed issues that produce routine monthly cash flows. Cash and due from banks decreased from \$6.9 million at December 31, 2009 to \$5.6 million at March 31, 2010. Excess liquidity in the current low interest rate environment is considered a drag on overall earnings. Therefore, management has intentionally allowed this portion of the balance sheet to shrink in order to foster growth of earning assets. As mentioned above, some of the excess liquidity has been used to absorb deposit runoff in the form of the redemption of high cost deposits for which adequate asset employment was not available.

Liability funding sources are also monitored. Demand and savings deposits, interest bearing and non-interest bearing, time deposits under \$100,000 are monitored with a targeted level of 52.5% or greater as a percentage of total assets. At March 31, 2010, this percentage was 65.9%. The Bank also maintains additional sources of liquidity through "Federal funds purchased" guidance lines with correspondent banks, which totaled \$4.8 million at March 31, 2010. In October 2007, the Bank joined the Federal Home Loan Bank ("FHLB"). The FHLB offers many services, but the primary service utilized by the Bank is the FHLB's loan programs. As of March 31, 2010, FHLB advances totaled \$7.5 million. The advances include two loans totaling \$1.5 million each, at fixed rates of 0.66% for one year, 1.20% for two years, respectively; one loan totaling \$2.0 million, at a fixed rate of 2.67% for three years and the fourth loan totaling \$2.5 million, at a fixed rate of 1.91% for two years. The Bank's current line of credit with the FHLB is \$25,060,000, thus, providing \$17,560,000 of additional availability. The Bank will not abandon its primary purpose of being a community bank and corporate partner to the markets it serves. However, utilization of alternative funding that is more economically priced will, over the long-term, bode well for net interest earnings. As a part of the ever increasing regulatory scrutiny, documentation of the overall liquidity position has increased in a parallel manner. The current regulatory environment dictates such exercises as stress testing scenarios for liquidity planning. The Bank also has recently expanded its use of more complex monitoring tools for forecasting usage of committed lines of credit, particularly consumer home equity lines of credit ("HELOCs"). The monitoring of these commitments is important in two primary ways. First the liquidity required to fund them must be available. Secondly, with the troubled economy and increasing unemployment rates, consumers are more likely to draw on their HELOC for simple living expenses at a time when their respective credit quality might be deteriorating. Therefore, management uses these monitoring tools for both liquidity and credit quality purposes. The Board approves and reviews wholesale funding sources not only for amount available, but also periodic testing by drawing on the lines of credit mentioned above.

### **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. However, refer to the discussion above concerning liquidity and credit quality issues within the Bank's HELOCs. 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. During the three months ended March 31, 2010, there has been no material change outside the ordinary course of the Bank's business in the contractual obligations specified in "Note 9." Financial Instruments with Off-Balance Sheet Risk" in the Bank's Annual Report on Form 10-K for the year ended December 31, 2009.

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.

### **Recent Accounting Pronouncements**

In June 2009, the FASB issued new guidance relating to the accounting for transfers of financial assets. The new guidance, which was issued as SFAS No. 166, "Accounting for Transfers of Financial Assets, an amendment to SFAS No. 140", was adopted into Codification in December 2009 through the issuance of Accounting Standards Updated ("ASU") 2009-16. The new standard provides guidance to improve the relevance, representational faithfulness, and comparability of the information that an entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor's continuing involvement, if any, in transferred financial assets. The adoption of the new guidance did not have a material impact on the Bank's financial statements.

In June 2009, the FASB issued new guidance relating to the variable interest entities. The new guidance, which was issued as SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)," was adopted into Codification in December 2009. The objective of the guidance is to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. SFAS No. 167 is effective as of January 1, 2010. The adoption of the new guidance did not have a material impact on the Bank's financial statements.

In October 2009, the FASB issued Accounting Standards Update No. 2009-15 (ASU 2009-15), "Accounting for Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance or Other Financing." ASU 2009-15 amends Subtopic 470-20 to expand accounting and reporting guidance for own-share lending arrangements issued in contemplation of convertible debt issuance. ASU 2009-15 is effective for fiscal years beginning on or after December 15, 2009 and interim periods within those fiscal years for arrangements outstanding as of the beginning of those fiscal years. The adoption of the new guidance did not have a material impact on the Bank's financial statements.

In January 2010, the FASB issued ASU 2010-04, *Accounting for Various Topics – Technical Corrections to SEC Paragraphs*. ASU 2010-04 makes technical corrections to existing SEC guidance including the following topics: accounting for subsequent investments, termination of an interest rate swap, issuance of financial statements - subsequent events, use of residential method to value acquired assets other than goodwill, adjustments in assets and liabilities for holding gains and losses, and selections of discount rate used for measuring defined benefit obligation. The adoption of the new guidance did not have a material impact on the Bank's financial statements.

In January 2010, the FASB issued Accounting Standards Update No. 2010-06, “Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements.” ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers’ disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of the new guidance did not have a material impact on the Bank’s financial statements.

In February 2010, the FASB issued Accounting Standards Update No. 2010-08, “Technical Corrections to Various Topics.” ASU 2010-08 clarifies guidance on embedded derivatives and hedging. ASU 2010-08 is effective for interim and annual periods beginning after December 15, 2009. The adoption of the new guidance did not have a material impact on the Bank’s financial statements.

In February 2010, the FASB issued Accounting Standards Update No. 2010-09, “Subsequent Events (Topic 855): Amendments to Certain Recognition and Disclosure Requirements.” ASU 2010-09 addresses both the interaction of the requirements of Topic 855 with the SEC’s reporting requirements and the intended breadth of the reissuance disclosures provisions related to subsequent events. An entity that is an SEC filer is not required to disclose the date through which subsequent events have been evaluated. ASU 2010-09 is effective immediately. The adoption of the new guidance did not have a material impact on the Bank’s financial statements.

### **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;
- changes in general economic and business conditions in the Bank’s market area;
- 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;
- maintaining capital levels adequate to support the Bank’s growth;
- the successful management of interest rate risk;
- changes in banking and other laws and regulations applicable to the Bank;
- the ability to continue to attract low cost core deposits to fund asset growth;
- reliance on the Bank’s management team, including its ability to attract and retain key personnel;
- changing trends in customer profiles and behavior;
- managing the cost and implementation of 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; and

- demand, development and acceptance of new products and services.

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.

**AVERAGE BALANCES, INTEREST INCOME  
AND EXPENSES, AVERAGE YIELDS AND RATES**

	Three months ended March 31, 2010			Three months ended March 31, 2009		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
<b>Assets:</b>						
Interest earning assets:						
Securities						
Taxable	\$36,351,252	364,408	4.01%	\$28,895,191	\$ 355,917	4.93%
Tax Exempt (1)	300,000	4,943	6.59%	179,981	3,021	6.71%
Total securities	36,651,252	369,351	4.03%	29,075,172	358,938	4.94%
Federal funds sold	2,522,389	1,241	0.20%	5,089,667	3,364	0.26%
Deposits at other banks	860,000	113	0.05%	3,220,835	890	0.11%
Loans, net	68,573,046	1,197,474	6.99%	64,148,619	1,142,614	7.12%
Total earning assets	108,606,687	1,568,179	5.78%	101,534,293	1,505,806	5.93%
Less: allowance for loan losses	(1,053,779)			(624,754)		
Total non-earning assets	14,269,240			10,274,286		
Total assets	121,822,148			111,183,825		
<b>Liabilities and Stockholders' Equity:</b>						
Interest bearing liabilities:						
Checking	7,362,482	15,745	0.86%	4,529,014	15,968	1.41%
Savings and money market deposits	27,392,485	75,485	1.10%	12,947,173	66,730	2.06%
Other time	59,722,221	331,775	2.22%	63,660,318	516,729	3.25%
Total interest bearing deposits	94,477,188	423,005	1.79%	81,136,505	599,427	2.96%
Short term borrowings	6,665,611	35,959	2.16%	10,166,667	45,621	1.79%
Total interest bearing liabilities	101,142,799	458,964	1.82%	91,303,172	645,048	2.83%
Noninterest bearing liabilities:						
Demand deposits	7,508,433			6,813,934		
Other non-interest bearing Liabilities	1,336,678			1,135,970		
Total liabilities	109,987,910			99,253,076		
Stockholders' equity	11,834,238			11,930,749		
Total liabilities and stockholders' equity	\$121,822,148			\$111,183,825		
Net Interest Income		\$ 1,109,215			\$ 860,758	
Interest rate spread <sup>(2)</sup>			3.96%			3.10%
Net Interest Margin <sup>(3)</sup>			4.09%			3.39%

(1) Income and yields are reported on a tax equivalent basis assuming a federal tax rate of 34%.

(2) Interest spread is the average yield earned on earning assets, calculated on a fully taxable equivalent basis assuming a federal tax rate of 34%, less the average rate incurred on interest-bearing liabilities.

(3) Net interest margin is the net interest income, calculated on a fully tax equivalent basis assuming a federal tax rate of 34%, expressed as a percentage of average earning assets.

**AVERAGE BALANCES, INTEREST INCOME  
AND EXPENSES, AVERAGE YIELDS AND RATES**

	Three months ended March 31, 2010			Year months ended December 31, 2009		
	Average Balance	Interest Income/ Expense	Yield/ Rate	Average Balance	Interest Income/ Expense	Yield/ Rate
<b>Assets:</b>						
Interest earning assets:						
Securities						
Taxable	\$36,351,252	364,408	4.01%	\$31,652,084	\$ 1,427,029	4.51%
Tax Exempt (1)	300,000	4,943	6.59%	271,480	17,850	6.58%
Total securities	36,651,252	369,351	4.03%	31,923,564	1,444,879	4.53%
Federal funds sold	2,522,389	1,241	0.20%	7,001,573	17,483	0.25%
Deposits at other banks	860,000	113	0.05%	1,886,201	1,738	0.09%
Loans, net	68,573,046	1,197,474	6.99%	65,222,897	4,580,828	7.02%
Total earning assets	108,606,687	1,568,179	5.78%	106,034,235	6,044,928	5.70%
Less: allowance for loan losses	(1,053,779)			(759,979)		
Total non-earning assets	14,269,240			11,533,132		
Total assets	121,822,148			116,807,388		
<b>Liabilities and Stockholders' Equity:</b>						
Interest bearing liabilities:						
Checking	7,362,482	15,745	0.86%	4,969,516	66,785	1.34%
Savings and money market deposits	27,392,485	75,485	1.10%	17,408,798	288,501	1.66%
Other time	59,722,221	331,775	2.22%	64,451,776	1,890,729	2.93%
Total interest bearing deposits	94,477,188	423,005	1.79%	86,830,090	2,246,015	2.59%
Short term borrowings	6,665,611	35,959	2.16%	8,900,000	174,568	1.96%
Total interest bearing liabilities	101,142,799	458,964	1.82%	95,730,090	2,420,583	2.53%
Noninterest bearing liabilities:						
Demand deposits	7,508,433			8,010,380		
Other non-interest bearing Liabilities	1,336,678			1,149,844		
Total liabilities	109,987,910			104,890,314		
Stockholders' equity	11,834,238			11,917,074		
Total liabilities and stockholders' equity	\$121,822,148			\$116,807,388		
Net Interest Income		\$ 1,109,215			\$ 3,624,345	
Interest rate spread <sup>(2)</sup>			3.96%			3.17%
Net Interest Margin <sup>(3)</sup>			4.09%			3.42%

(1) Income and yields are reported on a tax equivalent basis assuming a federal tax rate of 34%.

(2) Interest spread is the average yield earned on earning assets, calculated on a fully taxable equivalent basis assuming a federal tax rate of 34%, less the average rate incurred on interest-bearing liabilities.

(3) Net interest margin is the net interest income, calculated on a fully tax equivalent basis assuming a federal tax rate of 34%, expressed as a percentage of average earning assets.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable to smaller reporting companies.

**Item 4. 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 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.

The Bank's management is also responsible for establishing and maintaining adequate internal control over financial reporting. 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 March 31, 2010 that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

None

**Item 1A. Risk Factors**

Not applicable to smaller reporting companies.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None

**Item 3. Defaults upon Senior Securities**

None

**Item 4. (Removed and Reserved)**

**Item 5. Other Information**

None

**Item 6. Exhibits**

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

**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**COLONIAL VIRGINIA BANK**  
(Registrant)

Date: May 14, 2010

By:     /s/ Kenneth E. Smith      
Kenneth E. Smith (on behalf of the Bank and  
as principal financial officer)  
Executive Vice President and  
Chief Financial Officer

## EXHIBIT INDEX

### **Exhibits**

- 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

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

I, William J. Farinholt, certify that:

1. I have reviewed the Quarterly Report on Form 10-Q for the period ended March 31, 2010 of Colonial Virginia Bank;
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 registrant as of, and for, the periods presented in this report;
4. The registrant'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 registrant 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 registrant, 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 assurance 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 registrant'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; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant'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 registrant'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 registrant's internal control over financial reporting.

Date: May 14, 2010

/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 the Quarterly Report on Form 10-Q for the period ended March 31, 2010 of Colonial Virginia Bank;
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 registrant as of, and for, the periods presented in this report;
4. The registrant'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 registrant 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 registrant, 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 assurance 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 registrant'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; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant'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 registrant'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 registrant's internal control over financial reporting.

Date: May 14, 2010

/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 Quarterly Report on Form 10-Q for the period ended March 31, 2010 (the “Form 10-Q”) 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-Q 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-Q 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-Q.

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

Date: May 14, 2010

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

Date: May 14, 2010