

Board of Governors of the Federal Reserve System



Annual Report of Holding Companies—FR Y-6

Report at the close of business as of the end of fiscal year

This Report is required by law: Section 5(c)(1)(A) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(1)(A)); sections 8(a) and 13(a) of the International Banking Act (12 U.S.C. §§ 3106(a) and 3108(a)); sections 11(a)(1), 25, and 25A of the Federal Reserve Act (12 U.S.C. §§ 248(a)(1), 602, and 611a); and sections 113, 165, 312, 618, and 809 of the Dodd-Frank Act (12 U.S.C. §§ 5361, 5365, 5412, 1850a(c)(1), and 5468(b)(1)). Return to the appropriate Federal Reserve Bank the original and the number of copies specified.

This report form is to be filed by all top-tier bank holding companies, top-tier savings and loan holding companies, and U.S. intermediate holding companies organized under U.S. law, and by any foreign banking organization that does not meet the requirements of and is not treated as a qualifying foreign banking organization under Section 211.23 of Regulation K (12 C.F.R. § 211.23). (See page one of the general instructions for more detail of who must file.) The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, an information collection unless it displays a currently valid OMB control number.

NOTE: The *Annual Report of Holding Companies* must be signed by one director of the top-tier holding company. This individual should also be a senior official of the top-tier holding company. In the event that the top-tier holding company does not have an individual who is a senior official and is also a director, the chairman of the board must sign the report. If the holding company is an ESOP/ESOT formed as a corporation or is an LLC, see the General Instructions for the authorized individual who must sign the report.

Date of Report (top-tier holding company's fiscal year-end):  
**December 31, 2017**

I, Lorraine L. Brisell  
 Name of the Holding Company Director and Official  
President and Director  
 Title of the Holding Company Director and Official

Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)  
N/A

Reporter's Name, Street, and Mailing Address  
Cornerstone Financial Services, Inc  
 Legal Title of Holding Company  
251 Main Street/ PO Box 249  
 (Mailing Address of the Holding Company) Street / P.O. Box  
West Union WV 26456  
 City State Zip Code

attest that the *Annual Report of Holding Companies* (including the supporting attachments) for this report date has been prepared in conformance with the instructions issued by the Federal Reserve System and are true and correct to the best of my knowledge and belief.

Physical Location (if different from mailing address)

With respect to information regarding individuals contained in this report, the Reporter certifies that it has the authority to provide this information to the Federal Reserve. The Reporter also certifies that it has the authority, on behalf of each individual, to consent or object to public release of information regarding that individual. The Federal Reserve may assume, in the absence of a request for confidential treatment submitted in accordance with the Board's "Rules Regarding Availability of Information," 12 C.F.R. Part 261, that the Reporter and individual consent to public release of all details in the report concerning that individual.

Person to whom questions about this report should be directed:  
John W. See VP/CFO  
 Name Title

Lorraine L. Brisell  
 Signature of Holding Company Director and Official  
6/12/18  
 Date of Signature

304-873-3618  
 Area Code / Phone Number / Extension

304-873-2427  
 Area Code / FAX Number

JSee@Cornerstonebankwv.com  
 E-mail Address

N/A  
 Address (URL) for the Holding Company's web page

For holding companies not registered with the SEC—  
 Indicate status of Annual Report to Shareholders:

Is included with the FR Y-6 report  
 will be sent under separate cover  
 is not prepared

Is confidential treatment requested for any portion of this report submission? .....  0=No  1=Yes 0

In accordance with the General Instructions for this report (check only one),

1. a letter justifying this request is being provided along with the report .....

2. a letter justifying this request has been provided separately ...

NOTE: Information for which confidential treatment is being requested must be provided separately and labeled as "confidential."

For Federal Reserve Bank Use Only

RSSD ID \_\_\_\_\_  
 C.I. \_\_\_\_\_

**Form FR Y-6**

**Cornerstone Financial Services, Inc.  
West Union, West Virginia  
Fiscal Year Ending December 31, 2017**

**Report Item**

1: The bank holding company does prepare an annual report for its shareholders.  
Three copies are enclosed.

2a: Organization Chart- No LEI

**Cornerstone  
Financial  
Services, Inc.**  
  
**West Union, WV  
Incorporated in WV**

| 100%

**Cornerstone Bank,  
Inc.**  
  
**West Union, WV  
Incorporated in WV**

2b: See Attachments

Results: A list of branches for your depository institution: CORNERSTONE BANK, INC. (ID\_RSSD: 978239).  
 This depository institution is held by CORNERSTONE FINANCIAL SERVICES, INC. (3217537) of WEST UNION, WV.  
 The data are as of 12/31/2017. Data reflects information that was received and processed through 01/07/2018.

Data Action	Effective Date	Branch Service Type	Branch ID_RSSD*	Popular Name	Street Address	City	State	Zip Code	County	Country	FDIC UNINUM*	Office Number*	Head Office	Head Office ID_RSSD*	Comments
ok		Full Service (Head Office)	978239	CORNERSTONE BANK, INC.	251 MAIN STREET	WEST UNION	WV	26456	DODDRIDGE	UNITED STATES	6420		CORNERSTONE BANK, INC.	978239	
ok		Full Service	2051659	PENNSBORO BRANCH	4377 LAMBERTON ROAD	PENNSBORO	WV	26415	RITCHIE	UNITED STATES	221737		CORNERSTONE BANK, INC.	978239	
ok		Full Service	854931	SALEM BRANCH	150 EAST MAIN ST	SALEM	WV	26426	HARRISON	UNITED STATES	221736		CORNERSTONE BANK, INC.	978239	
ok	10/13/2015	Full Service	4911597	PARKERSBURG BRANCH	2107 PIKE STREET	PARKERSBURG	WV	26101	WOOD	UNITED STATES	572527		CORNERSTONE BANK, INC.	978239	



**Cornerstone Financial Services, Inc.  
Fiscal Year Ending December 31, 2017**

**Report Item 3: Shareholders**  
(1)(a) (1)(b) (1)(c) (2)(a) (2)(b) (2)(c)

Current Shareholders with ownership, control or holdings of 5% or more With power to vote as of 12-29-17			Shareholders not listed in (3)(1)(a) through 3(1)(c) that had ownership, control or holdings of 5% or more with power to vote during the fiscal year ending 12-29-17		
(1)(a) Name & Address (City, State, County)	(1)(b) Country of Citizenship Or Incorporation	(1)(c) Number and Percentage of Each Class of Voting Securities	(2)(a) Name & Address (City, State, County)	(2)(b) Country of Citizenship Or Incorporation	(2)(c) Number and Percentage of Each Class of Voting Securities
Craig G. Phillips Belington, WV	USA	435 – 8.7% common stock	None		
Rhonda M. Rossetti Bridgeport, WV 26330	USA	693 – 13.9% common stock  659 – 13.2% common stock Trustee of Earldean Spencer TRI FBO Rhonda Rossetti			
Ronald B. Spencer Smithburg, WV	USA	704 – 14.1% common stock  660- 13.2% common stock Trustee of Earldean Spencer TRI FBO Ronald Spencer			

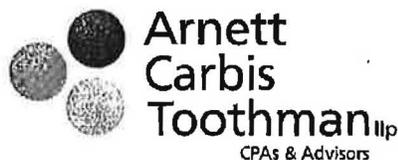
**Form FR Y-6**  
**Cornerstone Financial Services, Inc.**  
**December 31, 2017**

**Report Item 4: Insiders**

(1) (2) (3)(a)(b)(c) and (4)(a)(b)(c)

(1) Names & Address (City, State, Country)	(2) Principal Occupation if other than with Bank Holding Company	(3)(a) Title & Position with Bank Holding Company	(3)(b) Title & Position with Subsidiaries (include names of subsidiaries)	(3)(c) Title & Position with Other Businesses (include names of other businesses)	(4)(a) Percentage of voting shares in Bank Holding Company	(4)(b) Percentage of voting shares in subsidiaries (include names of subsidiaries)	(4)(c) List names of other companies (includes partnerships) if 25% or more of voting securities are held (List names of companies and percentage of voting securities held)
Ronald B. Spencer Smithburg, WV USA	President – Mid Atlantic of West Virginia	Director & Chairman	Director & Chairman (Cornerstone Bank, Inc.)	Manager – Spencer Enterprises	27.3% - (1)	None	Spencer Enterprises (50.0%) Mid Atlantic of West Virginia (37.5%) Ron and Ronda LLC (50%)
Michael T. Hall Ellenboro, WV USA	President – Hall Drilling LLC	Director & Vice President	Director (Cornerstone Bank, Inc.)	President and Owner – Halls WV Welding	2.8%	None	Hall Drilling LLC (50%) Halls WV Welding (100%)
Lorraine L. Brisell West Union, WV USA	N/A	Director & President	President, CEO and Director (Cornerstone Bank, Inc.)	N/A	.6%	None	N/A
Rhonda M. Rossetti Bridgeport, WV USA	Retired	Director	Director (Cornerstone Bank, Inc.)	N/A	27.1% - (2)	None	Spencer Enterprises (50.0%)
James R. Barton Parkersburg, WV USA	Co-owner – Wincore Windows	Director	Director (Cornerstone Bank, Inc.)	N/A	(3)	None	Wincore Windows (33.3%) WV Potato Chip Co (32%)
Kevin A. Fluharty Salem, WV USA	Vice President- Salem IGA	Director	Director (Cornerstone Bank, Inc.)	Managing Member Fluharty Development LLC, DBA Ace Hardware	(3)	None	Salem IGA (34%) Fluharty Development LLC, DBA Ace Hardware (100%)

- (1) Ronald Blaine Spencer owns 704 shares common stock of Cornerstone Financial Services, Inc. Additionally, Ronald Blaine Spencer is Trustee of Earledean Spencer TR1 FBO Ronald Blaine Spencer with 660 shares of common stock of Cornerstone Financial Services, Inc.
  - (2) Rhonda Margaret Rossetti owns 693 shares common stock of Cornerstone Financial Services, Inc. Additionally, Rhonda Margaret Rossetti is Trustee of Earledean Spencer TR1 FBO Rhonda Margaret Rossetti with 659 shares of common stock of Cornerstone Financial Services, Inc.
  - (3) Identified Director owns less than .5% of the authorized and outstanding common stock of Cornerstone Financial Services, Inc.
-



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101 Washington Street, East  
P.O. Box 2629  
Charleston, WV 25329  
304.346.0441 | 304.346.8333 fax  
800.642.3601

To the Audit Committee of the Board of Directors  
Cornerstone Financial Services, Inc.  
and subsidiary  
West Union, West Virginia

In planning and performing our audit of the financial statements of Cornerstone Financial Services, Inc. and subsidiary (Bank) as of and for the year ended December 31, 2017, in accordance with auditing standards generally accepted in the United States of America, we considered the Bank's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. Accordingly, we do not express an opinion on the effectiveness of the Bank's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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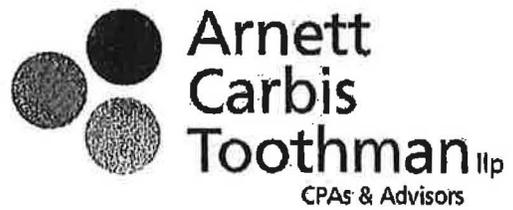
This communication is intended solely for the information and use of the Audit Committee, Board of Directors, Bank management, regulatory authorities and the Bank's bonding agent and is not intended to be, and should not be used by anyone other than these specified parties.

*Arnett Carbis Toothman LLP*

Charleston, West Virginia  
March 16, 2018

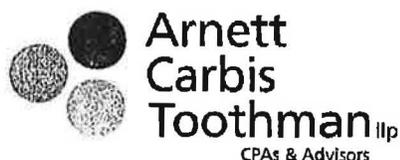


***Financial Report  
December 31, 2017***



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## INDEPENDENT AUDITOR'S REPORT

To the Audit Committee of the Board of Directors  
Cornerstone Financial Services, Inc. and subsidiary  
West Union, West Virginia

We have audited the accompanying consolidated financial statements of Cornerstone Financial Services, Inc., and subsidiary (Company), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for the three year period ended December 31, 2017 and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Cornerstone Financial Services, Inc. and subsidiary as of December 31, 2017 and 2016, and the results of their operations and cash flows for the three year period ended December 31, 2017 in accordance with accounting principles generally accepted in the United States of America.

*Arnett Carbis Toothman LLP*

Charleston, West Virginia  
March 16, 2018

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEETS

December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>ASSETS</b>		
Cash and due from banks	\$ 6,938,788	\$ 7,827,618
Interest bearing deposits and deposit notes with other banks	250,000	-
Federal funds sold	16,235,000	22,235,000
Securities available for sale	98,823,522	101,133,530
Loans, less allowance for loan losses of \$314,640 and \$288,773, respectively	36,154,524	32,454,595
Bank premises and equipment, net	945,346	985,144
Accrued interest receivable	929,087	883,200
Cash surrender value of life insurance	2,666,041	2,639,179
Other assets	1,224,377	1,204,836
<b>Total assets</b>	<u>\$ 164,166,685</u>	<u>\$ 169,363,102</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Deposits:		
Non-interest bearing	\$ 62,957,742	\$ 68,689,859
Interest bearing	81,877,912	82,539,215
<b>Total deposits</b>	144,835,654	151,229,074
Dividends payable	500,000	375,000
Other liabilities	1,750,927	1,629,703
<b>Total liabilities</b>	<u>147,086,581</u>	<u>153,233,777</u>
<b>Shareholders' Equity</b>		
Common stock, \$100 par value, authorized and issued 5,000 shares	500,000	500,000
Capital surplus	500,000	500,000
Retained earnings	16,474,832	16,000,220
Accumulated other comprehensive income	(394,728)	(870,895)
<b>Total shareholders' equity</b>	<u>17,080,104</u>	<u>16,129,325</u>
<b>Total liabilities and shareholders' equity</b>	<u>\$ 164,166,685</u>	<u>\$ 169,363,102</u>

See Notes to Consolidated Financial Statements

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

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**CONSOLIDATED STATEMENTS OF INCOME**  
**For the Years Ended December 31, 2017, 2016, and 2015**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Interest income:</b>			
Interest and fees on loans	\$ 1,720,756	\$ 1,648,837	\$ 1,595,672
Interest & dividends on securities:			
Taxable	1,550,829	1,684,142	1,634,247
Tax-exempt	873,976	817,182	821,048
Interest on Federal funds sold	153,925	64,168	77,765
Interest on interest bearing deposits and deposit notes with other banks	36	-	-
<b>Total interest income</b>	<u>\$ 4,299,522</u>	<u>\$ 4,214,329</u>	<u>\$ 4,128,732</u>
<b>Interest expense:</b>			
Interest expense on deposits	334,652	348,298	396,964
<b>Total interest expense</b>	<u>334,652</u>	<u>348,298</u>	<u>396,964</u>
<b>Net Interest Income</b>	<u>3,964,870</u>	<u>3,866,031</u>	<u>3,731,768</u>
Provision for loan losses	37,000	-	-
<b>Net interest income after provision     for loan losses</b>	<u>3,927,870</u>	<u>3,866,031</u>	<u>3,731,768</u>
<b>Other income:</b>			
Service fees on deposit accounts	122,522	127,836	121,390
Gain on sale of securities, net	23,925	38,545	6,152
Other	310,685	125,400	70,833
	<u>457,132</u>	<u>291,781</u>	<u>198,375</u>
<b>Other expenses:</b>			
Salaries and employee benefits	1,719,741	1,700,937	1,481,115
Net occupancy expense	125,617	131,182	132,058
Equipment rentals, depreciation and maintenance	158,198	156,338	122,986
Data processing fees	471,476	436,386	423,000
Regulatory expenses	64,923	100,786	98,701
Other	489,740	319,205	327,503
	<u>3,029,695</u>	<u>2,844,834</u>	<u>2,585,363</u>
<b>Income before income tax expense</b>	1,355,307	1,312,978	1,344,780
Income tax expense	380,695	241,299	127,476
<b>Net Income</b>	<u>\$ 974,612</u>	<u>\$ 1,071,679</u>	<u>\$ 1,217,304</u>
<b>Basic earnings per common share</b>	<u>\$ 194.92</u>	<u>\$ 214.34</u>	<u>\$ 243.46</u>
<b>Average common shares outstanding</b>	<u>5,000</u>	<u>5,000</u>	<u>5,000</u>

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2017, 2016 and 2015

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Net income</b>	\$ 974,612	\$ 1,071,679	\$ 1,217,304
Other comprehensive income:			
Gross unrealized gains (losses) arising during the period	805,913	(1,161,346)	(354,565)
Adjustments for income tax (expense) benefit	<u>(336,709)</u>	<u>423,891</u>	<u>129,417</u>
	469,204	(737,455)	(225,148)
Less: Reclassification adjustment for (gains) losses included in net income	(23,925)	(38,545)	(6,152)
Adjustment for income tax expense (benefit)	<u>8,733</u>	<u>14,069</u>	<u>2,245</u>
	<u>(15,192)</u>	<u>(24,476)</u>	<u>(3,907)</u>
Decrease in fair value of interest rate swap during the period	454,012	54,824	(55,645)
Adjustments for income tax (expense) benefit	<u>(27,435)</u>	<u>(20,011)</u>	<u>20,310</u>
	<u>426,577</u>	<u>34,813</u>	<u>(35,335)</u>
Other comprehensive income (loss), net of tax	<u>880,589</u>	<u>(727,118)</u>	<u>(264,390)</u>
<b>Comprehensive income</b>	<u>\$ 1,855,201</u>	<u>\$ 344,561</u>	<u>\$ 952,914</u>

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

STATEMENTS OF SHAREHOLDERS' EQUITY  
For the Years Ended December 31, 2017, 2016 and 2015

	Common Stock	Capital Surplus	Retained Earnings	Other Comprehensive Income	Total Shareholders' Equity
<b>Balance, December 31, 2014</b>	\$ 500,000	\$ 500,000	\$ 14,461,237	\$ 120,613	\$ 15,581,850
Net income	-	-	1,217,304	-	1,217,304
Dividends on common stock (\$70.00 per share)	-	-	(375,000)	-	(375,000)
Effect of treasury share transactions	-	-	-	-	-
Change in fair value of interest rate swap	-	-	-	(35,335)	(35,335)
Change in net unrealized gain (loss) on securities available for sale	-	-	-	(229,055)	(229,055)
<b>Balance, December 31, 2015</b>	500,000	500,000	15,303,541	(143,777)	16,159,764
Net income	-	-	1,071,679	-	1,071,679
Dividends on common stock (\$75.00 per share)	-	-	(375,000)	-	(375,000)
Change in fair value of interest rate swap	-	-	-	34,813	34,813
Change in net unrealized gain (loss) on securities available for sale	-	-	-	(761,931)	(761,931)
<b>Balance, December 31, 2016</b>	500,000	500,000	16,000,220	(870,895)	16,129,325
Net income	-	-	974,612	-	974,612
Dividends on common stock (\$100.00 per share)	-	-	(500,000)	-	(500,000)
Change in fair value of interest rate swap	-	-	-	22,155	22,155
Change in net unrealized gain (loss) on securities available for sale	-	-	-	454,012	454,012
<b>Balance, December 31, 2017</b>	<u>\$ 500,000</u>	<u>\$ 500,000</u>	<u>\$ 16,474,832</u>	<u>\$ (394,728)</u>	<u>\$ 17,080,104</u>

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

**STATEMENTS OF CASH FLOWS**  
**For the Years Ended December 31, 2017, 2016 and 2015**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net Income	\$ 974,612	\$ 1,071,679	\$ 1,217,304
Adjustments to reconcile net income to cash provided by (used in) operating activities:			
Depreciation	89,468	90,757	79,504
(Gain) on sales of securities, net	(23,925)	(38,545)	(6,152)
Deferred income tax expense (benefit)	119,652	12,192	(80,078)
Amortization of premiums on securities and interest bearing deposits with other banks, net	919,899	923,067	787,108
Provision for loan losses	37,000	-	-
(Increase) in cash surrender value	(26,862)	(42,361)	(14,850)
(Increase) in accrued interest receivable	(45,887)	(43,627)	(144,764)
(Increase) decrease in other assets	(139,193)	48,513	(159,587)
Increase (decrease) in other liabilities	(83,522)	258,623	257,731
<b>Net cash provided by operating activities</b>	<u>1,821,242</u>	<u>2,280,298</u>	<u>1,936,216</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Proceeds from maturities and calls of securities available for sale	3,845,000	20,597,308	1,155,000
Proceeds from sales of securities available for sale	6,773,069	9,706,690	2,549,017
Principal payments received on securities available for sale	5,533,058	6,009,184	5,237,957
Purchases of securities available for sale	(13,931,180)	(35,260,584)	(29,892,066)
Purchases of interest bearing deposits with other banks	(250,000)	-	-
(Increase) decrease in Federal funds sold	6,000,000	(5,000)	28,610,000
Principal collected on (loans made to) customers, net	(3,736,929)	(790,678)	3,284
Purchases of Bank premises and equipment	(49,670)	(10,932)	(258,110)
<b>Net cash provided by investing activities</b>	<u>4,183,348</u>	<u>245,988</u>	<u>7,405,082</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net (decrease) in demand deposits, money market and savings accounts	(3,668,908)	(4,095,921)	(3,658,140)
Proceeds from sales of (payments for maturing) time deposits, net	(2,724,512)	2,818,051	(603,974)
Dividends paid	(500,000)	(375,000)	(375,000)
<b>Net cash provided by (used in) financing activities</b>	<u>(6,893,420)</u>	<u>(1,652,870)</u>	<u>(4,637,114)</u>

(Continued)

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

**STATEMENTS OF CASH FLOWS (Continued)**  
**For the Years Ended December 31, 2017, 2016 and 2015**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Cash and due from banks:</b>			
Beginning	7,827,618	6,954,202	2,250,018
Ending	<u>\$ 6,938,788</u>	<u>\$ 7,827,618</u>	<u>\$ 6,954,202</u>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW</b>			
<b>INFORMATION</b>			
Cash payments for:			
Interest on deposits	<u>\$ 360,429</u>	<u>\$ 375,593</u>	<u>\$ 430,210</u>
Income taxes	<u>\$ 256,780</u>	<u>\$ 115,661</u>	<u>\$ 190,463</u>
<b>SUPPLEMENTAL SCHEDULE OF NONCASH</b>			
<b>INVESTING AND FINANCING ACTIVITIES</b>			
Dividends declared and unpaid	<u>\$ 500,000</u>	<u>\$ 375,000</u>	<u>\$ 375,000</u>

**See Notes to Consolidated Financial Statements**

**CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Note 1. Significant Accounting Policies**

**Nature of business:** Cornerstone Financial Services, Inc. is a one-bank holding company. The wholly-owned subsidiary, Cornerstone Bank, Inc., formerly First National Bank in West Union, (the subsidiary bank), is a community bank with operations in Doddridge, Ritchie, Wood and Harrison Counties, and provides retail and commercial loans and deposit services to individuals and small businesses in these and adjacent counties. These entities are collectively referred to as "the Company."

**Basis of presentation:** The accounting and reporting policies of Cornerstone Financial Services, Inc. and its wholly-owned subsidiary conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry.

**Principles of consolidation:** The accompanying consolidated financial statements include the accounts of Cornerstone Financial Services, Inc. and its wholly-owned subsidiary, Cornerstone Bank, Inc. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Use of estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. For the year ended December 31, 2017, we evaluated subsequent events through March 16, 2018, the date the financial statements were available to be issued.

**Presentation of cash flows:** For purposes of reporting cash flows, cash and due from banks includes cash on hand and amounts due from banks (including cash items in process of clearing). Cash flows from demand deposits, NOW accounts, savings accounts and Federal funds purchased and sold are reported net since their original maturities are less than three months. Cash flows from loans, interest bearing deposits with other banks and certificates of deposit and other time deposits are reported net.

**Securities:** Debt and equity securities are classified as "held to maturity," "available for sale" or "trading" according to management's intent. The appropriate classification is determined at the time of purchase of each security and re-evaluated at each reporting date.

**Securities held to maturity** - Debt securities for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for amortization of premiums and accretion of discounts.

**Securities available for sale** - Securities not classified as "held to maturity" or as "trading" are classified as "available for sale." Securities classified as "available for sale" are those securities the Bank intends to hold for an indefinite period of time, but not necessarily to maturity. "Available for sale" securities are reported at estimated fair value, net of unrealized gains or losses, which are adjusted for applicable income taxes, and reported as a separate component of shareholders' equity.

**Trading securities** - There are no securities classified as "trading" in the accompanying financial statements.

Realized gains and losses on sales of securities are recognized on the specific identification method. Amortization of premiums and accretion of discounts are computed using the interest method.

**CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Other than temporary impairment:** Declines in the fair value of available for sale and held to maturity securities 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 issuers, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for an anticipated recovery in fair value. In addition, the risk of future other than temporary impairment may be influenced by additional bank failures, prolonged recession in the U.S. economy, changes to real estate values, interest deferrals and whether the Federal government provides assistance to financial institutions.

**Loans and allowance for loan losses:** Loans are stated at the amount of unpaid principal, reduced by unearned (if any) income and an allowance for loan losses.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. The allowance is adjusted by provisions charged to operating expense and reduced by net charge-offs. The subsidiary bank makes continuous credit reviews of the loan portfolio and considers current economic conditions, historical loan loss experience, review of specific problem loans and other factors in determining the adequacy of the allowance for loan losses. Loans are charged against the allowance for loan losses when management believes that the collectability is unlikely. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in conditions.

Unearned interest on discounted loans is amortized to income over the life of the loans, using methods which approximate the interest method. For all other loans, interest is accrued daily on the outstanding balances.

A loan is impaired when, based on current information and events, it is probable that the subsidiary bank will be unable to collect all amounts due in accordance with contractual terms of the specific loan agreement. Impaired loans, other than certain large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, are required to be reported at the present value of expected future cash flows discounted using the loan's original effective interest rate or, alternatively, at the loan's observable market price, or at the fair value of the loan's collateral if the loan is collateral dependent. The method selected to measure impairment is made on a loan-by-loan basis, unless foreclosure is deemed to be probable, in which case the fair value of the collateral is used.

For purposes of evaluating impairment, the subsidiary bank considers groups of smaller-balance, homogeneous loans to include: mortgage loans secured by residential property, other than those which significantly exceed the subsidiary bank's typical residential mortgage loan amount (currently those in excess of \$70,000); small balance commercial loans (currently those less than \$50,000) and installment loans to individuals, exclusive of those loans in excess of \$50,000.

Generally, after management's evaluation, loans are placed on non-accrual status when principal or interest is greater than 90 days past due based upon the loan's contractual terms. Interest is accrued daily on impaired loans unless the loan is placed on non-accrual status. Impaired loans are placed on non-accrual status when the payments of principal and interest are in default for a period of 90 days, unless the loan is both well-secured and in the process of collection. Interest on non-accrual loans is recognized primarily using the cost-recovery method.

**CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Certain loan fees and direct loan costs are recognized as income or expense when incurred, whereas, Accounting Standards Codification (ASC) Topic 310 requires that such fees and costs be deferred and amortized as adjustments of the related loan's yield over the contractual life of the loan. The subsidiary bank's method of recognition of loan fees and direct loan costs produces results which are not materially different from those that would be recognized had ASC Topic 310 been adopted.

**Bank premises and equipment:** Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed primarily by the straight-line method for Bank premises and equipment over the estimated useful lives of the assets. Repairs and maintenance expenditures are charged to operating expenses as incurred. Major improvements and additions to premises and equipment are capitalized.

**Other real estate:** Other real estate consists primarily of real estate held for resale which was acquired through foreclosure on loans secured by such real estate. At the time of acquisition, these properties are recorded at fair value less costs to sell with any write down being charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Expenses incurred in connection with operating these properties are insignificant and are charged to losses on foreclosed real estate. Gains and losses on the sales of these properties are credited or charged to operating income in the year of the transactions.

**Income taxes:** The provision for income taxes includes Federal and state income taxes and is based on pretax income reported in the consolidated financial statements, adjusted for transactions that may never enter into the computation of income taxes payable. Deferred tax assets and liabilities are determined based on differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. Valuation allowances are established, when deemed necessary, to reduce deferred tax assets to the amount expected to be realized.

**Earnings per share:** Basic earnings per common share are computed based upon the weighted average shares outstanding. The weighted average shares outstanding were 5,000 for each of the years in the period ended December 31, 2017, 2016 and 2015, respectively. During each of the three years in the period ended December 31, 2017 the Company did not have any potentially dilutive securities.

**Advertising Expense:** The Company expenses advertising costs as incurred.

**Restricted Investment Securities:** The subsidiary bank is a member of the Federal Home Loan Bank (FHLB) system. FHLB members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest additional amounts. FHLB stock is considered an equity security which is included in other assets in the accompanying consolidated financial statements. Such securities are carried at cost since they may only be sold back to the respective issuer or another member at par value. These securities are classified as restricted securities and are periodically evaluated for impairment based on the ultimate recovery of par value. Both cash and dividends are reported as income.

**Derivative Financial Instruments:** The Bank utilizes derivative financial instruments to reduce interest rate risk. The Bank does not hold or issue derivative financial instruments for trading purposes. The Bank recognizes all derivatives as either assets or liabilities and measures those instruments at fair value. The changes in the fair value of the Bank's

**CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

derivative instruments are recorded as changes in other comprehensive income (OCI) and flow through equity as they qualify for hedge accounting.

**Significant Authoritative Guidance:** ASU 2015-01, *Income Statement - Extraordinary and Unusual Items (Subtopic 225-20) - Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items* eliminates from U.S. GAAP the concept of extraordinary items, which, among other things, required an entity to segregate extraordinary items considered to be unusual and infrequent from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. ASU 2015-01 was effective January 1, 2016, and did not have a significant impact on the financial statements.

ASU 2016-01, *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, among other things, (a) certain equity investments to be measured at fair value with changes recognized in net income; (b) a qualitative assessment to identify impairment of equity investments without readily determinable fair value; (c) elimination of disclosures of the fair value of financial instruments measured at amortized costs and method(s) and significant assumptions used to estimate the fair value; (d) the exit price notion be used when measuring fair value; (e) separate presentation in other comprehensive income of the portion of the total change in the fair value of a liability; (f) separate presentation of financial assets and financial liabilities by measurement category and form of financial asset; and (g) clarification of how to evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. This guidance is effective for public entities for fiscal years beginning after December 15, 2017, and for other entities, including not-for-profit entities and employee benefit plans within the scope of Topic 960 through 965 on plan accounting, for fiscal years beginning after December 15, 2018. Early adoption is not permitted except for certain exceptions for public entities. The Company is currently evaluating the impact, if any, that adoption will have on its consolidated financial statements.

ASU 2016-02, *Leases (Topic 842)* will, among other things, require the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease; however, unlike current U.S. GAAP, which requires that only capital leases be recognized on the balance sheet, the ASU requires that both types of leases be recognized on the balance sheet. The ASU also requires disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. Lessor accounting remains largely unchanged from current U.S. GAAP, but the ASU contains some targeted improvements that are intended to align, where necessary, lessor accounting with the lessee accounting model and with the updated revenue recognition guidance issued in May 2014. Transition guidance is provided within the ASU and generally requires a retrospective approach. This guidance is effective for public entities with annual reporting periods beginning after December 15, 2018. For all other entities (nonpublic entities), the amendments in these ASUs will be effective for annual reporting periods beginning after December 15, 2019. Early application of the amendments in this guidance is permitted for all entities. The Company is evaluating the impact, if any, that adoption will have on its consolidated financial statements.

ASU 2016-09 *Compensation - Stock Compensation (TOPIC 718): Improvements to Employee Share-Based Accounting* provides guidance with the purpose of simplifying several aspects of the accounting for share-based payment award transactions, including income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The guidance also simplifies that private companies can now apply a practical expedient to estimate the expected term for all awards with performance or service conditions that have certain characteristics. Private companies can also now make a one-time election to switch from measuring all liability-classified awards at fair value to

**CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

measuring them at intrinsic value. This guidance is effective for public entities for fiscal years beginning after December 15, 2016, and for all other entities for fiscal years beginning after December 15, 2017. Early adoption is permitted. The Company is currently evaluating the impact, if any, that adoption will have on its consolidated financial statements

ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, issues guidance to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. This guidance replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to assess credit loss estimates. The guidance will require a financial asset measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset to present the net carrying value at the amount expected to be collected on the financial asset. The guidance will eliminate the probable initial recognition threshold in current GAAP, and instead, reflect an entity's current estimate of all expected credit losses. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses rather than a write-down. An entity will be able to record reversals of credit losses in current period net income, which, in turn, should align the income statement recognition of credit losses within the reporting period in which changes occur. The guidance affects entities holding financial assets and net investments in leases that are not accounted for at fair value through net income. This guidance is effective for all public entities that are U.S. Securities Exchange Commission (SEC) filers for fiscal years beginning after December 15, 2019. For all other entities, including not-for-profit entities and employee benefit plans within the scope of Topic 960 through 965 on plan accounting, guidance is effective for fiscal years beginning after December 15, 2020. All entities may adopt the amendments in this ASU as of the fiscal years beginning after December 15, 2018. The Company is currently evaluating the impact, if any, that adoption will have on its consolidated financial statements.

ASU 2016-15, *Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments* provides guidance to address eight specific cash flow issues with the objective of reducing the existing diversity in the practice. This guidance is effective for all public entities for fiscal years beginning after December 15, 2017. For all other entities, this guidance is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. The Company is currently evaluating the impact, if any, that adoption will have on its consolidated financial statements.

ASU 2017-01- *Business Combinations (Topic 805): Clarifying the Definition of a Business* clarifies the definition of a business relative to adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. The amendments in this ASU provide a screen to determine when an integrated set of assets and activities (collectively referred to as a "set") is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not a business. If the screen is not met, it (1) requires that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output, and (2) removes the evaluation of whether a market participant could replace the missing elements. This guidance is effective for public entities with fiscal years ending after December 15, 2017, and for all other entities for fiscal years ending after December 15, 2018. Early adoption is permitted, under certain circumstances and amendments should be applied on a prospective basis. The Company is currently evaluating the impact, if any, that adoption will have on its consolidated financial statements.

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

ASU 2017-08 – Receivables – *Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities* provides guidance to amend the amortization period for certain purchased callable debt securities held at a premium. The FASB is shortening the amortization period for the premium to the earliest call date. Under current GAAP, entities generally amortize the premium as an adjustment of yield over the contractual life of the instrument. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. This guidance is effective for public entities for fiscal years beginning after December 15, 2018, and for all other entities for fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company is currently evaluating the impact, if any, that adoption will have on its consolidated financial statements.

**Reclassifications:** Certain accounts in the financial statements for 2016 and 2015, as previously presented, have been reclassified to conform to current year classifications.

**Note 2. Cash Restrictions and Cash Concentrations**

The subsidiary bank is required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank and other institutions. The total of such reserve balances approximated \$860,000 and \$287,000 at December 31, 2017 and 2016, respectively.

At December 31, 2017, the subsidiary bank had a concentration of Federal funds sold, which consisted of approximately \$16,235,000.

**Note 3. Securities**

The amortized costs, unrealized gains and losses, and estimated fair values of securities at December 31, 2017 and 2016, are summarized as follows:

	2017			Carrying Value (Estimated Fair Value)
	Amortized Cost	Unrealized		
		Gains	Losses	
<b>Available for sale:</b>				
<b>Taxable:</b>				
U.S. Government agencies and corporations	\$ 19,567,905	\$ 11,296	\$ 628,732	\$ 18,950,469
Mortgage-backed securities-				
U.S. Government agencies and corporations	19,076	1,259	2	20,333
Collateralized Mortgage Obligations	1,900,082	-	9,061	1,891,021
SBA Pools	37,747,524	27,854	601,702	37,173,676
Other securities	12,149,586	122,768	17,418	12,254,936
<b>Total</b>	<b>\$ 71,384,173</b>	<b>\$ 163,177</b>	<b>\$ 1,256,915</b>	<b>\$ 70,290,435</b>
<b>Tax-exempt:</b>				
Tax-exempt obligations of states and political subdivisions	\$ 27,883,526	\$ 715,217	\$ 65,656	\$ 28,533,087
<b>Total</b>	<b>27,883,526</b>	<b>715,217</b>	<b>65,656</b>	<b>28,533,087</b>
<b>Total</b>	<b>\$ 99,267,699</b>	<b>\$ 878,394</b>	<b>\$ 1,322,571</b>	<b>\$ 98,823,522</b>

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	2016			Carrying Value (Estimated Fair Value)
	Amortized Cost	Unrealized		
		Gains	Losses	
<b>Available for sale:</b>				
<b>Taxable:</b>				
U.S. Government agencies and corporations	\$ 19,849,333	\$ 30,052	\$ 721,314	\$ 19,158,071
<b>Mortgage-backed securities-</b>				
U.S. Government agencies and corporations	3,474,745	53,949	36,702	3,491,992
<b>Collateralized Mortgage Obligations</b>	2,401,166	-	65,511	2,335,655
<b>SBA Pools</b>	37,662,926	42,693	743,006	36,962,613
<b>Other securities</b>	14,557,303	175,659	143,506	14,589,456
<b>Total</b>	<u>\$ 77,945,473</u>	<u>\$ 302,353</u>	<u>\$ 1,710,039</u>	<u>\$ 76,537,787</u>
<b>Tax-exempt:</b>				
Tax-exempt obligations of states and political subdivisions	\$ 24,438,147	\$ 475,895	\$ 318,299	\$ 24,595,743
<b>Total</b>	<u>24,438,147</u>	<u>475,895</u>	<u>318,299</u>	<u>24,595,743</u>
<b>Total</b>	<u>\$ 102,383,620</u>	<u>\$ 778,248</u>	<u>\$ 2,028,338</u>	<u>\$ 101,133,530</u>

Mortgage-backed obligations of U.S. Government agencies and corporations are included in securities at December 31, 2017 and 2016. These obligations, having contractual maturities ranging from 6 to 20 years, are reflected in the following maturity distribution schedule based on their anticipated average life to maturity which ranges from 1 year to 6 years. Accordingly, discounts are accreted and premiums are amortized over the anticipated average life to maturity of the specific obligations.

The maturities, amortized cost and estimated fair values of securities at December 31, 2017, are summarized as follows:

	Available for Sale	
	Amortized Cost	Carrying Value (Estimated Fair Value)
Due within 1 year	\$ 1,374,642	\$ 1,383,522
Due after 1 but within 5 years	13,172,607	13,103,761
Due after 5 but within 10 years	28,865,718	28,360,418
Due after 10 years	55,854,732	55,975,821
	<u>\$ 99,267,699</u>	<u>\$ 98,823,522</u>

The maturity distribution above includes securities available for sale with amortized costs totaling \$44,947,475 and estimated fair values of \$45,220,462, which are callable by their issuer prior to maturity.

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The proceeds from sales, calls and maturities of securities and principal payments received on mortgage-backed securities and the related gross gains and losses realized are as follows:

For the Years Ended December 31,	Proceeds From			Gross Realized	
	Sales	Calls and Maturities	Prinicipal Payments	Gains	Losses
<b>2017</b>					
<b>Securities available     for sale</b>	<u>\$ 6,773,069</u>	<u>\$ 3,845,000</u>	<u>\$ 5,533,058</u>	<u>\$ 82,162</u>	<u>\$ 58,237</u>
<b>2016</b>					
<b>Securities available     for sale</b>	<u>\$ 9,706,690</u>	<u>\$ 20,597,308</u>	<u>\$ 6,009,184</u>	<u>\$ 85,091</u>	<u>\$ 46,546</u>
<b>2015</b>					
<b>Securities available     for sale</b>	<u>\$ 2,549,017</u>	<u>\$ 1,155,000</u>	<u>\$ 5,237,957</u>	<u>\$ 6,490</u>	<u>\$ 338</u>

At December 31, 2017 and 2016, securities carried at \$9,298,147 and \$10,865,371 respectively, with estimated fair values of \$9,250,828 and \$10,814,052 respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

Included in obligations of state and political subdivisions at December 31, 2017 and 2016, were certain concentrations in obligations of the following states:

	2017		2016	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Illinois	\$ 3,428,773	\$ 3,273,423	\$ 3,435,010	\$ 3,273,423
Missouri	1,746,177	1,752,318	648,787	647,532
Pennsylvania	3,220,278	3,300,590	3,694,458	3,797,990
Texas	5,183,884	5,323,165	3,688,550	3,755,734
Wisconsin	1,696,038	1,745,227	1,701,242	1,670,784
	<u>\$ 15,275,150</u>	<u>\$ 15,394,723</u>	<u>\$ 13,168,047</u>	<u>\$ 13,145,463</u>

There were no significant concentrations to any one political subdivision or agency within the states mentioned above.

Impairment is evaluated considering numerous factors, and their relative significance varies case to case. Factors considered include the length of time and extent to which the market value has been less than cost; the financial condition and near-term prospects of the issuer; and the intent and ability to retain the security in order to allow for an anticipated recovery in market value. If, based on the analysis, it is determined that the impairment is other-than-temporary, the security is written down to fair value, and a loss is recognized through earnings.

The Bank has 41 securities in an unrealized loss position as of December 31, 2017. These securities are predominately rated investment grade securities (AA or better) and the unrealized losses are due to overall fluctuations in market interest rates and not due to any underlying credit concerns of the issuers. The Company has the intent and ability to hold

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

such investments until maturity or market price recovery. Accordingly, the Bank has concluded that none of the securities in its investment portfolios are other-than-temporarily impaired at December 31, 2017.

Provided below is a summary of securities available for sale which were in an unrealized loss position at December 31, 2017 and 2016, respectively.

	2017					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>Available for Sale:</b>						
U.S. Government agencies and corporations	\$ -	\$ -	\$ 18,218,997	\$ (628,732)	\$ 18,218,997	\$ (628,732)
Mortgage-backed securities-U.S. Government agencies and Corporations	1,267	(2)	-	-	1,267	(2)
Collateralized Mortgage Obligations	1,891,021	(9,061)	-	-	1,891,021	(9,061)
SBA Pools	11,992,186	(123,963)	22,972,883	(477,739)	34,965,069	(601,702)
State and political subdivisions	-	-	2,435,105	(65,656)	2,435,105	(65,656)
Other securities	4,653,370	(17,418)	-	-	4,653,370	(17,418)
	<u>\$18,537,844</u>	<u>\$ (150,444)</u>	<u>\$ 43,626,985</u>	<u>\$ (1,172,127)</u>	<u>\$ 62,164,829</u>	<u>\$ (1,322,571)</u>
	2016					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>Available for Sale:</b>						
U.S. Government agencies and corporations	\$ 17,349,630	\$ (694,339)	\$ 1,060,208	\$ (26,975)	\$ 18,409,838	\$ (721,314)
Mortgage-backed securities-U.S. Government agencies and Corporations	1,862,916	(36,702)	-	-	1,862,916	(36,702)
Collateralized Mortgage Obligations	2,335,655	(65,511)	-	-	2,335,655	(65,511)
SBA Pools	10,700,143	(160,593)	23,618,199	(582,413)	34,318,342	(743,006)
State and political subdivisions	8,641,783	(248,568)	813,094	(69,731)	9,454,877	(318,299)
Other securities	6,357,063	(143,506)	-	-	6,357,063	(143,506)
	<u>\$ 47,247,190</u>	<u>\$ (1,349,219)</u>	<u>\$ 25,491,501</u>	<u>\$ (679,119)</u>	<u>\$ 72,738,691</u>	<u>\$ (2,028,338)</u>

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 4. Loans

Loans are summarized as follows:

	<u>2017</u>	<u>2016</u>
Commercial, financial and agricultural	\$ 2,324,255	\$ 3,310,467
Commercial real estate	14,027,180	10,057,767
Real estate mortgage	18,846,842	18,056,325
Installment loans	1,242,034	1,288,952
Other	28,853	29,857
Total loans	<u>36,469,164</u>	<u>32,743,368</u>
Less allowance for loan losses	<u>314,640</u>	<u>288,773</u>
Loans, net	<u>\$ 36,154,524</u>	<u>\$ 32,454,595</u>

The following presents loan maturities at December 31, 2017:

	<u>Within 1 Year</u>	<u>After 1 But Within 5 Years</u>	<u>After 6 Years</u>
Commercial, financial and agricultural	\$ 1,651,412	\$ 652,082	\$ 20,761
Commercial real estate	2,438,435	3,327,769	8,260,976
Real estate mortgage	1,190,126	3,138,863	14,517,853
Installment loans and other	541,010	697,872	32,005
Total	<u>\$ 5,820,983</u>	<u>\$ 7,816,586</u>	<u>\$ 22,831,595</u>
Loans due after one year with:			
Variable rates	\$ 26,328,086		
Fixed rates	<u>4,320,095</u>		
	<u>\$ 30,648,181</u>		

The following tables set forth the Bank's age analysis of its past due loans, segregated by class of loans.

At December 31, 2017

	<u>Past Due</u>				<u>Current</u>	<u>Total Loans</u>	<u>Recorded Investments ≥ 90 days and Accruing</u>
	<u>30-59 days</u>	<u>60-89 days</u>	<u>≥ 90 days</u>	<u>Total</u>			
Commercial, financial and agricultural	\$ -	\$ -	\$ -	\$ -	\$ 2,324,255	\$ 2,324,255	\$ -
Commercial real estate	-	-	-	-	14,027,180	14,027,180	-
Installment loans	6,847	1,373	4,868	13,082	1,257,805	1,270,887	4,868
Real estate	200,105	-	7,800	207,905	18,638,937	18,846,842	7,800
Total	<u>\$ 206,952</u>	<u>\$ 1,373</u>	<u>\$ 12,668</u>	<u>\$ 220,987</u>	<u>\$ 36,248,177</u>	<u>\$ 36,469,164</u>	<u>\$ 12,668</u>

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At December 31, 2016

	Past Due				Current	Total Loans	Recorded Investments ≥ 90 days and Accruing
	30-59 days	60-89 days	≥ 90 days	Total			
Commercial, financial and agricultural	\$ -	\$ -	\$ -	\$ -	\$ 3,310,467	\$ 3,310,467	\$ -
Commercial real estate	-	-	-	-	10,057,767	10,057,767	-
Installment loans	3,406	1,745	2,876	8,027	1,310,782	1,318,809	2,876
Real estate	423,149	-	586,737	1,009,886	17,046,439	18,056,325	586,737
<b>Total</b>	<b>\$ 426,555</b>	<b>\$ 1,745</b>	<b>\$ 589,613</b>	<b>\$ 1,017,913</b>	<b>\$ 31,725,455</b>	<b>\$ 32,743,368</b>	<b>\$ 589,613</b>

The following table presents the non-accrual loans included in the net balance of loans at December 31, 2017 and 2016, respectively.

	December 31, 2017	December 31, 2016
Commercial, financial and agricultural	\$ -	\$ -
Commercial real estate	-	-
Installment loans	-	-
Real estate	-	54,529
<b>Total</b>	<b>\$ -</b>	<b>\$ 54,529</b>

If interest on non-accrual loans had been accrued, such income would have approximated \$0, \$1,036 and \$0 for each of the three years in the period ended December 31, 2017.

Loans are categorized into risk categories based on relevant information about the ability of borrowers to service their debt such as current financial information, historical payment experience, credit documentation, and current economic trends, among other factors.

**Pass:** Loans that are secured by cash and cash equivalents or have characteristics that reduce credit risk in the transaction, as well as minimal documentation exceptions or no identification risk of collection. The loan would not subsequently introduce loan-loss risk. They are loans that do not fit any of the other categories described below.

**Watch List:** Loans that are generally satisfactory with the exception of supporting documentation, lack of financial information, defined source of repayment, previous slowness but currently paying as agreed. Typically, these loans will have a specific plan of action by the loan officer, to correct the deficiencies, provide a plan of repayment, or work the credit out of the Bank.

**Substandard:** The assets in this category are currently protected but are potentially weak. Credit risk may be relatively minor yet constitute an unwarranted risk in light of the circumstances surrounding a specific asset.

**Doubtful:** Loans inadequately protected by the current sound net worth and paying capacity of the obligor, or pledged collateral, if any, to a point where collection or liquidation in full is highly improbable. There is a distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

**Loss:** Loans that are considered to be un-collectible and of such little value that their continuance as active assets of the Bank is not warranted. This assignment does not mean that an asset has absolutely no recovery or salvage value, but simply that it is not practicable or desirable to defer writing off the basically worthless asset, even though partial recovery may be affected in the future.

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following tables set forth the Bank's credit quality indicators information by class of loans:

	December 31, 2017				
	Commercial	Commercial Real Estate	Installment	Real Estate	Total
Pass	\$ 2,278,938	\$ 14,027,180	\$ 1,266,459	\$ 18,065,708	\$ 35,638,285
Other Loans especially mentioned	-	-	-	-	-
Substandard	45,317	-	4,428	781,134	\$ 830,879
Doubtful	-	-	-	-	-
<b>Total</b>	<b>\$ 2,324,255</b>	<b>\$ 14,027,180</b>	<b>\$ 1,270,887</b>	<b>\$ 18,846,842</b>	<b>\$ 36,469,164</b>

	December 31, 2016				
	Commercial	Commercial Real Estate	Installment	Real Estate	Total
Pass	\$ 3,247,221	\$ 10,057,767	\$ 1,317,032	\$ 17,160,759	\$ 31,782,779
Other Loans especially mentioned	-	-	-	-	-
Substandard	63,246	-	1,777	895,566	960,589
Doubtful	-	-	-	-	-
<b>Total</b>	<b>\$ 3,310,467</b>	<b>\$ 10,057,767</b>	<b>\$ 1,318,809</b>	<b>\$ 18,056,325</b>	<b>\$ 32,743,368</b>

The following tables set forth the Bank's impaired loans information by class of loans:

	December 31, 2017				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Income Recognized
<b>With no related allowance</b>					
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate	-	-	-	-	-
Installment	-	-	-	-	-
Real estate	-	-	-	-	-
<b>Total with no related allowance</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
<b>With a related allowance</b>					
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate	-	-	-	-	-
Installment	-	-	-	-	-
Real estate	-	-	-	-	-
<b>Total with a related allowance</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Total</b>					
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate	-	-	-	-	-
Installment	-	-	-	-	-
Real estate	-	-	-	-	-
<b>Total</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	December 31, 2016				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Income Recognized
<b>With no related allowance</b>					
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate	-	-	-	-	-
Installment	-	-	-	-	-
Real estate	319,554	319,554	-	320,524	5,963
<b>Total with no related allowance</b>	<b>\$ 319,554</b>	<b>\$ 319,554</b>	<b>\$ -</b>	<b>\$ 320,524</b>	<b>\$ 5,963</b>
<b>With a related allowance</b>					
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate	-	-	-	-	-
Installment	-	-	-	-	-
Real estate	-	-	-	-	-
<b>Total with a related allowance</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Total</b>					
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate	-	-	-	-	-
Installment	-	-	-	-	-
Real estate	319,554	319,554	-	320,524	5,963
<b>Total</b>	<b>\$ 319,554</b>	<b>\$ 319,554</b>	<b>\$ -</b>	<b>\$ 320,524</b>	<b>\$ 5,963</b>

The Bank strives to maintain a diversified loan portfolio and grants commercial, residential and consumer loans to customers primarily located in Doddridge, Harrison, Ritchie and Wood counties, West Virginia. The economies of these counties are heavily influenced by the oil and gas industry.

The Bank has participated in loans originated by other financial institutions. These loans are secured by each participant's pro-rata portion of commercial real estate. As of December 31, 2017 and 2016, the unpaid balance of these loan participations approximated \$7,034,000 and \$3,112,000, respectively.

In the past, the Bank has made loans, in the normal course of business, to its directors, officers and employees and will continue to make such loans in the future. At December 31, 2017 and 2016, outstanding loans to directors and officers totaled approximately \$716,000 and \$296,000, respectively.

The following presents the activity with respect to related party loans aggregating \$60,000 or more to any one related party during the years ended December 31, 2017 and 2016.

	2017	2016
<b>Balance, beginning</b>	\$ 247,464	\$ 67,458
Additions	457,775	194,987
Amounts collected	(17,249)	(14,981)
Other changes, net	-	-
<b>Balance, ending</b>	<b>\$ 687,990</b>	<b>\$ 247,464</b>

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 5. Allowance for Loan Losses

An analysis of the allowance for loan losses for the years ended December 31, 2017, 2016, and 2015, is as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Balance, beginning of year</b>	\$ 288,773	\$ 288,648	\$ 301,138
<b>Losses:</b>			
Commercial, financial and agricultural	-	-	-
Real estate- mortgage	-	-	-
Installment loans	<u>14,740</u>	<u>1,306</u>	<u>13,330</u>
<b>Total</b>	<u>14,740</u>	<u>1,306</u>	<u>13,330</u>
<b>Recoveries:</b>			
Commercial, financial and agricultural	-	-	-
Real estate- mortgage	300	75	-
Installment loans	<u>3,307</u>	<u>1,356</u>	<u>840</u>
<b>Total</b>	<u>3,607</u>	<u>1,431</u>	<u>840</u>
Net (losses) recoveries	(11,133)	125	(12,490)
Provision for loan losses	<u>37,000</u>	<u>-</u>	<u>-</u>
<b>Balance, end of year</b>	<u>\$ 314,640</u>	<u>\$ 288,773</u>	<u>\$ 288,648</u>

The allowance is comprised of three distinct reserve components: (1) specific reserves related to loans individually evaluated, (2) quantitative reserves related to loans collectively evaluated, and (3) qualitative reserves related to loans collectively evaluated. A summary of the methodology the Bank employs on a quarterly basis with respect to each of these components in order to evaluate the overall adequacy of our allowance for loan losses is as follows.

**Specific Reserve for Loans Individually Evaluated**

The Bank identifies loan relationships through its watchlist that may also have credit weaknesses. Such loan relationships are identified primarily through the analysis of internal loan evaluations, past due loan reports, and loans adversely classified by regulatory authorities. Each loan so identified is then individually evaluated to determine whether it is impaired – that is, based on current information and events; it is probable that the Bank will be unable to collect all amounts due in accordance with the contractual terms of the underlying loan agreement. The Bank measures impairment based on the fair value of the loan's collateral, which is generally, determined utilizing current appraisals. A specific reserve is established in an amount equal to the excess, if any, of the recorded investment in each impaired loan over the fair value of its underlying collateral, less estimated costs to sell.

**Quantitative Reserve for Loans Collectively Evaluated**

Second, The Bank stratifies the loan portfolio into the following loan pools: commercial, commercial real estate, residential 1-4 family, residential construction, consumer and other. Loans within each pool are then further segmented between (1) loans which were individually evaluated for impairment and not deemed to be impaired, (2) smaller-balance homogenous loans.

Quantitative reserves relative to each loan pool are established using an allocation equaling 100% of the respective pool's average 3 year historical net loan charge-off rate (determined based upon the most recent 36 months) which is applied to the aggregate recorded investment in the smaller-balance homogenous pool of loans.

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Qualitative Reserve for Loans Collectively Evaluated

Third, The Bank considers the necessity to adjust the average historical net loan charge-off rates relative to each of the above loan pools for potential risk factors that could result in actual losses deviating from prior loss experience. Such qualitative risk factors considered are: (1) levels of and trends in delinquencies and impaired loans, (2) levels of and trends in charge-offs and recoveries, (3) trends in volume and term of loans, (4) effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practice, (5) experience, ability, and depth of lending management and other relevant staff, (6) national and local economic trends and conditions, (7) industry conditions, and (8) effects of changes in credit concentrations.

For purposes of evaluating impairment, the Bank considers groups of smaller-balance, homogeneous loans to include; mortgage loans secured by residential property, other than those which significantly exceed the bank's typical residential mortgage loan amount (currently those in excess of \$100,000); and installment loans to individuals, exclusive of those loans in excess of \$50,000.

A progression of the allowance for loan losses, by portfolio segment for the years ended December 31, 2017 and 2016 is as follows:

	December 31, 2017					Total
	Commercial, Financial and Agricultural	Commercial Real Estate	Installment	Real Estate	Allowance for Estimated Imprecision	
<b>Allowance for loan losses:</b>						
Beginning balance	\$ 48,368	\$ 137,759	\$ (5,551)	\$ 108,197	\$ -	\$ 288,773
Charge-offs	-	-	(14,740)	-	-	(14,740)
Recoveries	-	-	3,307	300	-	3,607
Provision	-	37,000	-	-	-	37,000
<b>Ending balance</b>	<b>\$ 48,368</b>	<b>\$ 174,759</b>	<b>\$ (16,984)</b>	<b>\$ 108,497</b>	<b>\$ -</b>	<b>\$ 314,640</b>
<b>Allowance related to:</b>						
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	48,368	174,758	(16,983)	108,497	-	314,640
<b>Total</b>	<b>\$ 48,368</b>	<b>\$ 174,758</b>	<b>\$ (16,983)</b>	<b>\$ 108,497</b>	<b>\$ -</b>	<b>\$ 314,640</b>
<b>Loans:</b>						
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ 334,350	\$ -	\$ 334,350
Collectively evaluated for impairment	2,324,255	14,027,180	1,270,887	18,512,492	-	36,134,814
<b>Total</b>	<b>\$ 2,324,255</b>	<b>\$ 14,027,180</b>	<b>\$ 1,270,887</b>	<b>\$ 18,846,842</b>	<b>\$ -</b>	<b>\$ 36,469,164</b>

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2016

	Commercial, Financial and Agricultural	Commercial Real Estate	Installment	Real Estate	Allowance for Estimated Imprecision	Total
<b>Allowance for loan losses:</b>						
Beginning balance	\$ 48,368	\$ 137,759	\$ (5,601)	\$ 108,122	\$ -	\$ 288,648
Charge-offs	-	-	(1,306)	-	-	(1,306)
Recoveries	-	-	1,356	75	-	1,431
Provision	-	-	-	-	-	-
<b>Ending balance</b>	<b>\$ 48,368</b>	<b>\$ 137,759</b>	<b>\$ (5,551)</b>	<b>\$ 108,197</b>	<b>\$ -</b>	<b>\$ 288,773</b>
<b>Allowance related to:</b>						
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	48,368	137,759	(5,551)	108,197	-	288,773
<b>Total</b>	<b>\$ 48,368</b>	<b>\$ 137,759</b>	<b>\$ (5,551)</b>	<b>\$ 108,197</b>	<b>\$ -</b>	<b>\$ 288,773</b>
<b>Loans:</b>						
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ 319,554	\$ -	\$ 319,554
Collectively evaluated for impairment	3,310,467	10,057,767	1,318,809	17,736,771	-	32,423,814
<b>Total</b>	<b>\$ 3,310,467</b>	<b>\$ 10,057,767</b>	<b>\$ 1,318,809</b>	<b>\$ 18,056,325</b>	<b>\$ -</b>	<b>\$ 32,743,368</b>

There were no troubled debt restructurings for the years ended December 31, 2017 or 2016.

**Note 6. Bank Premises and Equipment**

The major categories of Bank premises and equipment and accumulated depreciation at December 31, 2017 and 2016 are summarized as follows:

	2017	2016
Land	\$ 156,348	\$ 156,348
Buildings and improvements	1,444,404	1,444,404
Furniture and equipment	1,002,360	978,020
Leashold improvements	32,220	32,220
	<u>2,635,332</u>	<u>2,610,992</u>
Less accumulated depreciation	<u>1,689,986</u>	<u>1,625,848</u>
<b>Bank premises and equipment, net</b>	<b>\$ 945,346</b>	<b>\$ 985,144</b>

Depreciation expense for the years ended December 31, 2017, 2016 and 2015, totaled \$89,468, \$90,757 and \$79,504, respectively.

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 7. Deposits

The following is a summary of interest bearing deposits by type as of December 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Money market accounts	\$ 15,832,924	\$ 15,833,258
Savings deposits	23,235,486	21,171,942
Regular certificates of deposit	40,908,542	43,569,809
Individual retirement accounts and other time deposits	<u>1,900,961</u>	<u>1,964,206</u>
<b>Total</b>	<b><u>\$ 81,877,912</u></b>	<b><u>\$ 82,539,215</u></b>

Time certificates of deposit in denominations of \$250,000 or more totaled \$29,214,479 and \$30,189,074 as of December 31, 2017 and 2016, respectively. Interest paid on time certificates of deposit in denominations of \$250,000 or more was \$216,808, \$223,830 and \$213,725 for the years ended December 31, 2017, 2016 and 2015, respectively.

The following is a summary of the maturity distribution of certificates of deposit in amounts of \$250,000 or more as of December 31, 2017:

	<u>Amount</u>	<u>Percent</u>
Three months or less	\$ 13,444,806	47%
Three through six months	4,795,751	16%
Six through twelve months	7,701,239	26%
Over twelve months	<u>3,272,683</u>	<u>11%</u>
<b>Total</b>	<b><u>\$ 29,214,479</u></b>	<b><u>100.00%</u></b>

At December 31, 2017, the scheduled maturities of regular certificates of deposit, individual retirement accounts and other time deposits are as follows:

2017	\$ 35,573,736
2018	3,897,955
2019	1,641,292
2020	563,288
2021	<u>1,133,232</u>
	<b><u>\$ 42,809,503</u></b>

The Bank had related party deposits totaling \$28,908,680 and \$27,959,402 at December 31, 2017 and 2016, respectively. The Bank is a holder of deposits for one related party totaling \$16,424,366 and \$14,855,924 at December 31, 2017 and 2016, respectively, which represents a concentration.

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 8. Income Taxes

The components of applicable income tax expense (benefit) for the years ended December 31, 2017, 2016 and 2015, are as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Current:			
Federal	\$ 212,267	\$ 180,106	\$ 188,692
State	48,776	49,001	18,862
	<u>261,043</u>	<u>229,107</u>	<u>207,554</u>
Deferred (Federal and state)	119,652	12,192	(80,078)
Total	<u>\$ 380,695</u>	<u>\$ 241,299</u>	<u>\$ 127,476</u>

A reconciliation between the amount of reported income tax expense and the amount computed by multiplying the statutory Federal income tax rate by book pretax income for the years ended December 31, 2017, 2016 and 2015, is as follows:

	<u>2017</u>		<u>2016</u>		<u>2015</u>	
	Amount	Percent	Amount	Percent	Amount	Percent
Computed tax expense (benefit) at applicable statutory Federal rate	\$ 460,927	34.0	\$ 446,413	34.0	\$ 457,225	34.0
Increase (decrease) in taxes resulting from:						
Tax exempt interest	(195,549)	(14.4)	(248,098)	(18.9)	(279,156)	(20.8)
Non-deductible interest used to carry tax exempt securities	2,229	0.2	3,590	0.3	4,793	0.4
State income taxes (benefit), net of Federal tax benefit	38,533	2.8	32,341	2.5	12,449	0.9
Increase in cash surrender value of life insurance	5,641	0.4	(14,830)	(1.1)	(5,049)	(0.4)
Other, net	68,914	5.1	21,883	1.7	(62,786)	(4.7)
Applicable income taxes	<u>\$ 380,695</u>	<u>28.1</u>	<u>\$ 241,299</u>	<u>18.5</u>	<u>\$ 127,476</u>	<u>9.4</u>

Deferred income taxes for 2017, 2016 and 2015, reflect the impact of "temporary differences" between amounts of assets and liabilities for financial reporting purposes and such amounts as measured for tax purposes. Deferred tax assets and liabilities represent the future tax return consequences of temporary differences, which will either be taxable or deductible when the related assets and liabilities are recovered or settled.

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The tax effects of temporary differences which create the Bank's deferred tax assets and liabilities as of December 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
<b>Deferred tax assets:</b>		
Allowance for loan losses	\$ 27,179	\$ 32,773
Supplemental executive and director compensation plan	359,477	487,260
Interest rate swap	16,875	44,310
Net unrealized loss on securities	104,382	456,283
	<u>507,913</u>	<u>1,020,626</u>
<b>Deferred tax liabilities:</b>		
Discount accretion on tax exempt securities	(11,072)	(6,893)
Depreciation	(22,106)	(40,010)
	<u>(33,178)</u>	<u>(46,903)</u>
<b>Net deferred tax assets</b>	<u>\$ 474,735</u>	<u>\$ 973,723</u>

Accounting Standards Update (ASU) 2009-16 was issued to provide additional implementation guidance on accounting for uncertainty in income taxes and to eliminate the disclosures required by FASB Accounting Standards Codification (ASC) Paragraphs 740-10-50-15(a) through (b) for non public entities. The Company adopted this standard on January 1, 2011. As of the date of the adoption, the Company had no unrecognized tax benefits such benefits would impact the effective tax rate if recognized. The Company is subject to U.S. Federal income tax examination for the returns filed after December 31, 2010. State income tax returns are generally subject to a period of examination for a period of three to five years. There were no unrecognized tax benefits at December 31, 2017 or 2016.

**Note 9. Commitments and Contingencies**

The Bank entered into an employment contract with the Chief Executive Officer which provides for the continuation of employment under certain circumstances. Under the terms of the agreement, this continuation of employment occurs in the event of a merger with or the acquisition by another financial institution or company.

Due to the nature of business of the Bank, which involves extensions of credit and collection of loans, and the enforcement of liens, security interests and mortgages, the Bank is plaintiff or defendant in various legal proceedings from time to time. Management does not anticipate the outcome of such claims or actions to have a material effect on the Bank's financial position.

**Note 10. Financial Instruments with Off-Balance Sheet Risk**

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. The financial instruments consist of commitments to extend credit and involve elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The contract amounts reflect the extent of involvement the Bank has in the financial instruments.

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Financial instruments whose contract amounts represent credit risk	Contract Amount	
	2017	2016
Commitments to extend credit	\$ 5,382,691	\$ 1,475,364
Letters of credit	975,319	890,319
<b>Total</b>	<b>\$ 6,358,010</b>	<b>\$ 2,365,683</b>

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

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 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. Collateral held varies but may include accounts receivable, inventory, equipment or real estate.

**Note 11. Employee Benefit Plan**

The Bank has a Simple IRA Retirement Plan which is a voluntary employee savings plan. Participation is available to all employees who have received at least \$5,000 in compensation in any two previous calendar years and expect to receive at least \$5,000 in compensation for the current calendar year. Employees can elect to defer a percentage of their salary not to exceed \$12,500 per year for 2017, 2016 and 2015, respectively. The Bank matches the employee's contribution to the plan up to 3% of the employee's salary. All contributions to the plan are 100% vested to the covered employees. The Bank contributed \$17,661, \$15,623 and \$15,455 to the plan for the calendar years ended December 31, 2017, 2016 and 2015.

**Note 12. Supplemental Executive and Director Retirement Plan**

In December 2001, the Bank entered into a non-qualified Supplemental Executive and Director Retirement Plan (SEDRP) with the Chief Executive Officer and Directors which provides the Chief Executive Officer and participating Directors with an income benefit payable at retirement age or death. The provisions of the SEDRP became effective January 1, 2002. The liability accrued under this plan at December 31, 2017 and 2016 was \$1,529,684 and \$1,334,960, respectively, which is included in other liabilities in the accompanying balance sheets. Expenses for the SEDRP totaled \$194,724, \$175,093 and \$157,163 for the years ended December 31, 2017, 2016, and 2015, respectively. In addition, the Bank purchased certain life insurance contracts on the Directors and Officers in connection with this plan. At December 31, 2017 and 2016, the cash surrender values of these insurance contracts was \$2,666,041 and \$2,639,179, respectively.

**Note 13. Regulatory Restrictions on Capital and Dividends**

The primary source of funds for the dividends paid by the Company is dividends received from its subsidiary bank. Dividends paid by the subsidiary bank are subject to restrictions by banking regulations. The most restrictive provision requires approval by the regulatory agency if dividends declared in any year exceed the year's net income, as defined, plus the retained net profits of the two preceding years.

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Cornerstone Financial Services, Inc. and the subsidiary bank are subject to various regulatory capital requirements administered by the Federal banking agencies. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Cornerstone Financial Services, Inc. and the subsidiary bank must meet specific capital guidelines that involve quantitative measures of Cornerstone Financial Services, Inc.'s and the subsidiary bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices.

Quantitative measures established by regulation to ensure capital adequacy require Cornerstone Financial Services, Inc. and the subsidiary bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined) common equity Tier I (CET1) (as defined) to total risk weighted assets and of Tier I capital (as defined) to average assets (as defined). Management believes that as of December 31, 2017, Cornerstone Financial Services, Inc. and the subsidiary bank meet all capital adequacy requirements to which they are subject.

The most recent notification from the Federal Deposit Insurance Corporation categorized Cornerstone Financial Services, Inc. and the subsidiary bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, Cornerstone Financial Services, Inc. and the subsidiary bank must maintain minimum total risk-based, Tier I risk-based and Tier I 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.

Cornerstone Financial Services, Inc.'s and the subsidiary bank's actual capital amounts and ratios are presented in the following table (in thousands):

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Actions Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	As of December 31, 2017					
<b>CET1</b>						
(to Risk-Weighted Assets)						
Cornerstone Financial Services, Inc.	\$ 17,459	29.7%	\$ 2,646	4.5%	\$ 3,821	6.5%
Cornerstone Bank	\$ 17,459	29.7%	\$ 2,646	4.5%	\$ 3,821	6.5%
<b>Total Capital</b>						
(to Risk-Weighted Assets)						
Cornerstone Financial Services, Inc.	\$ 17,773	30.2%	\$ 4,703	8.0%	\$ 5,879	10.0%
Cornerstone Bank	\$ 17,773	30.2%	\$ 4,703	8.0%	\$ 5,879	10.0%
<b>Tier I Capital</b>						
(to Risk-Weighted Assets)						
Cornerstone Financial Services, Inc.	\$ 17,459	29.7%	\$ 3,527	6.0%	\$ 4,703	8.0%
Cornerstone Bank	\$ 17,459	29.7%	\$ 3,527	6.0%	\$ 4,703	8.0%
<b>Tier I Capital</b>						
(to Average Assets)						
Cornerstone Financial Services, Inc.	\$ 17,459	10.6%	\$ 6,561	4.0%	\$ 8,201	5.0%
Cornerstone Bank	\$ 17,459	10.6%	\$ 6,561	4.0%	\$ 8,201	5.0%

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	Actual		For Capital		To Be Well Capitalized	
			Adequacy Purposes		Under Prompt Corrective	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>As of December 31, 2016</b>						
<b>CET1</b>						
(to Risk-Weighted Assets)						
Cornerstone Financial Services, Inc.	\$ 17,004	28.5%	\$ 2,686	4.5%	\$ 3,880	6.5%
Cornerstone Bank	\$ 17,004	28.5%	\$ 2,686	4.5%	\$ 3,880	6.5%
<b>Total Capital</b>						
(to Risk-Weighted Assets)						
Cornerstone Financial Services, Inc.	\$ 17,292	29.0%	\$ 4,776	8.0%	\$ 5,970	10.0%
Cornerstone Bank	\$ 17,292	29.0%	\$ 4,776	8.0%	\$ 5,970	10.0%
<b>Tier I Capital</b>						
(to Risk-Weighted Assets)						
Cornerstone Financial Services, Inc.	\$ 17,004	28.5%	\$ 3,582	6.0%	\$ 4,776	8.0%
Cornerstone Bank	\$ 17,004	28.5%	\$ 3,582	6.0%	\$ 4,776	8.0%
<b>Tier I Capital</b>						
(to Average Assets)						
Cornerstone Financial Services, Inc.	\$ 17,004	10.0%	\$ 6,834	4.0%	\$ 8,543	5.0%
Cornerstone Bank	\$ 17,004	10.0%	\$ 6,834	4.0%	\$ 8,543	5.0%

**Note 14. Fair Value Measurements**

ASC Topic 820 – *Fair Value Measurements* (ASC 820) defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

**Level 1:** Quoted prices (unadjusted) or identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

**Level 2:** Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

**Level 3:** Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Accordingly, securities available-for-sale is recorded at fair value on a recurring basis. Additionally, from time to time, the Bank may be required to record other assets at fair value on a nonrecurring basis, such as impaired loans. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

**CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Available-for-Sale Securities:** Investment securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, mortgage backed securities and municipal bonds. Level 3 securities include local community development bonds.

**Loans:** The Bank does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, *Accounting by Creditors for Impairment of a Loan*. The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2016 and 2015, substantially all of the total impaired loans were evaluated based on the fair value of collateral. In accordance with ASC Topic 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank records the impaired loans as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral and there is no observable market price, the Bank records the impaired loan as nonrecurring Level 3.

**Other Real Estate Owned ("OREO"):** OREO consists of real estate acquired in foreclosure or other settlement of loans. Such assets are carried on the balance sheet at the lower of the investment in the real estate or its fair value less estimated selling costs. The fair value of OREO is determined on a nonrecurring basis generally utilizing current appraisals performed by an independent, licensed appraiser applying an income or market value approach using observable market data (Level 2). However, if a current appraisal is not available, the original appraised value is discounted, as appropriate, to compensate for the estimated depreciation in the value of the real estate since the date of its original appraisal. Such discounts are generally estimated based upon management's knowledge of sales of similar property within the applicable market area and its knowledge of other real estate market-related data as well as general economic trends (Level 3). Upon foreclosure, any fair value adjustment is charged against the allowance for loan losses. Subsequent fair value adjustments are recorded in the period incurred and included in other noninterest income in the consolidated statements of income.

**Derivative Financial Instruments:** Derivative financial instruments are recorded at fair value on a recurring basis. Fair value measurement is based on pricing models run by third-party sources, utilizing observable market-based inputs. All future floating cash flows are protected and both floating and fixed cash flows are discounted to the valuation date. The Bank designates the \$4,985,000 Pay Fixed Interest Rate Swaps with Vining Sparks Interest Rate Products, LLC as a fair value hedge of its exposure to changes in the fair value of the hedged exposure attributable to changes in LIBOR. The Bank anticipates holding the hedged securities until the hedge maturity date. Therefore, the securities are classified as interest rate swaps with a fair value measurement of Level 2.

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis.

	Total at December 31, 2017	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Available for Sale:				
U.S. Government agencies and corporations	\$ 18,950,469	\$ -	\$ 18,950,469	\$ -
Mortgage-backed securities- U.S. Government agencies and corporations	20,333	-	20,333	-
Collateralized Mortgage Obligations	1,891,021	-	1,891,021	-
SBA Pools	37,173,676	-	37,173,676	-
Other securities	12,254,936	-	12,254,936	-
Federal Home Loan Bank stock	77,200	-	77,200	-
Tax exempt obligations of state and political subdivisions	28,533,087	-	28,533,087	-
Derivative Financial Instruments:				
Interest Rate Swap	(71,808)	-	(71,808)	-
	<u>\$ 98,828,914</u>	<u>\$ -</u>	<u>\$ 98,828,914</u>	<u>\$ -</u>
	Total at December 31, 2016	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
Available for Sale:				
U.S. Government agencies and corporations	\$ 19,158,071	\$ -	\$ 19,158,071	\$ -
Mortgage-backed securities- U.S. Government agencies and corporations	3,491,992	-	3,491,992	-
Collateralized Mortgage Obligations	2,335,655	-	2,335,655	-
SBA Pools	36,962,613	-	36,962,613	-
Other securities	14,589,456	-	14,589,456	-
Federal Home Loan Bank stock	83,300	-	83,300	-
Tax exempt obligations of state and political subdivisions	24,595,743	-	24,595,743	-
Derivative Financial Instruments:				
Interest Rate Swap	(121,398)	-	(121,398)	-
	<u>\$ 101,095,432</u>	<u>\$ -</u>	<u>\$ 101,095,432</u>	<u>\$ -</u>

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Assets Recorded at Fair Value on a Nonrecurring Basis

The Bank may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the tables below:

	Total at December 31, 2017	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Impaired loans				
Commercial	\$ -	\$ -	\$ -	\$ -
Commercial Real Estate	-	-	-	-
Real Estate	-	-	-	-
Installment	-	-	-	-
<b>Total Impaired Loans</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>
<b>OREO</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

	Total at December 31, 2016	Fair Value Measurements Using:		
		Level 1	Level 2	Level 3
<b>Assets:</b>				
Impaired loans				
Commercial	\$ -	\$ -	\$ -	\$ -
Commercial Real Estate	319,554	-	-	319,554
Real Estate	-	-	-	-
Installment	-	-	-	-
<b>Total Impaired Loans</b>	<b>\$ 319,554</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 319,554</b>
<b>OREO</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

## Note 15. Fair Value of Financial Instruments

The following summarizes the methods and significant assumptions used by the subsidiary bank in estimating its fair value disclosures for financial instruments.

**Cash and due from banks**

The carrying values of cash and due from banks approximate their estimated fair value.

**Interest bearing deposits with other banks**

The fair value of interest bearing deposits with other banks are estimated by discounting scheduled future receipts of principal and interest at the current rates offered on similar instruments with similar remaining maturities.

**Securities**

Estimated fair values of securities are based on quoted market prices, where available. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable securities.

**Federal funds sold**

The carrying values of Federal funds sold approximate their estimated fair values.

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Loans**

The estimated fair values of loans are computed based on scheduled future cash flows of principal and interest, discounted at interest rates currently offered for loans with similar terms to borrowers of similar credit quality. No prepayments of principal are assumed.

**Accrued interest receivable and payable**

The carrying values of accrued interest receivable and payable approximate their estimated fair value.

**Cash surrender value of life insurance policies**

The carrying value of the cash value of life insurance policies approximates their estimated fair value.

**Deposits**

The estimated fair values of demand deposits (i.e., non interest bearing checking, NOW, Super NOW and money market), savings accounts and other variable rate deposits approximate their carrying values. Fair values of fixed maturity deposits are estimated using a discounted cash flow methodology at rates currently offered for deposits with similar remaining maturities. Any intangible value of long-term relationships with depositors is not considered in estimating the fair values disclosed.

**Long-term borrowings**

The fair values of long-term borrowings are estimated by discounting scheduled future payments of principal and interest at current rates available on borrowings with similar terms.

**Derivative financial instruments:** The fair value of the interest rate swaps is valued using independent pricing models.

**Off-balance sheet instruments**

The fair values of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present credit standing of the counterparties. The amounts of fees currently charged on commitments and standby letters of credit are deemed insignificant, and therefore, the estimated fair values and carrying values are not shown below. The carrying values and estimated fair values of the Company's financial instruments are summarized below:

	December 31, 2017		December 31, 2016	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Financial assets:</b>				
Cash and due from banks	\$ 6,938,788	\$ 6,938,788	\$ 7,827,618	\$ 7,827,618
Interest bearing deposits with other banks	250,000	250,000	-	-
Federal funds sold	16,235,000	16,235,000	22,235,000	22,235,000
Securities available for sale	98,823,522	98,823,522	101,133,530	101,133,530
Loans	36,154,524	36,676,000	32,454,595	32,133,000
Accrued interest receivable	929,087	929,087	883,200	883,200
Cash surrender value of life insurance policies	2,666,041	2,666,041	2,639,179	2,639,179
<b>Total</b>	<b>\$ 161,996,962</b>	<b>\$ 162,518,438</b>	<b>\$ 167,173,122</b>	<b>\$ 166,851,527</b>

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	December 31, 2017		December 31, 2016	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
<b>Financial liabilities:</b>				
Deposits	\$ 144,835,654	\$ 137,221,000	\$ 151,229,074	\$ 145,055,000
Accrued interest payable	13,005	13,005	12,772	12,772
Interest rate swap	71,808	71,808	121,398	121,398
<b>Total</b>	<b>\$ 144,920,467</b>	<b>\$ 137,305,813</b>	<b>\$ 151,363,244</b>	<b>\$ 145,189,170</b>

**Note 16. Leases**

The Bank leases a building in Parkersburg, WV under an operating lease expiring in 2019. The operating leases provide for one renewal option for the period of five years. In the normal course of business, operating leases are generally renewed or replaced by other leases.

Year ending December 31,	Minimum Lease Payments
2018	\$ 78,000
2019	45,500
2020	-
2021	-
2022	-
<b>Total minimum lease payments</b>	<b>\$ 123,500</b>

Lease expense charged to operations amounted to \$78,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

**Note 17. Derivate Financial Instruments and Hedging Activities**

The Bank manages certain exposures to changes in market interest rates. The Bank's use of derivative instruments is limited to highly effective fixed and floating rate swap agreements used to management well-defined interest rate exposures. The Bank monitors its positions and credit ratings of its counterparties and does not anticipate non-performance by the counterparties. Interest rate swap agreements are not entered into for trading purposes.

At October 30, 2014 the Bank was party to an interest rate swap agreement which terminates on January 1, 2025. The swap agreement is with Vining Sparks and aggregates an initial \$4,985,000 in notional principal amount and \$4,985,000 of outstanding notional principal at December 31, 2017 and 2016. This swap effectively converted \$4,985,000 of fixed rate bonds to variable rate bonds. The swap agreement requires to the Bank to make fixed rate interest payments based on a multiple of LIBOR and to receive variable rate interest payments from the issuers of the related bonds based on the respective stated interest rates of the underlying bonds. In 2017 and 2016, ineffectiveness totaling approximately \$(340) and \$1,950 was charged to expense in the consolidated statement of operations. The net additional interest payments made or received under this swap agreement are recognized in interest income. All future floating cash flows are protected and both floating and fixed cash flows are discounted to the valuation date. At December 31, 2017 and 2016, the estimated fair market value of the swap liability was approximately \$71,808 and \$121,398 and is recorded in other liabilities in the consolidated financial statements.

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Note 1B. Condensed Financial Statements of Parent Company

Cornerstone Financial Services, Inc., was formed for the sole purpose of becoming a bank holding company and through an exchange of common stock, acquired all of the stock of Cornerstone Bank, Inc. The Company was incorporated on July 18, 2003 and the Plan of Share Exchange was consummated at the close of business on December 31, 2003. The investment of the company in its wholly-owned bank subsidiary is presented on the equity method of accounting. Information relative to the Cornerstone Financial Services, Inc. balance sheet at December 31, 2017 and 2016 and the related statements of income and cash flows for the periods ended December 31, 2017, 2016, and 2015 are presented below:

	<u>2017</u>	<u>2016</u>
<b><u>Balance Sheets</u></b>		
<b>Assets</b>		
Cash	\$ 2,720	\$ 378,080
Accounts receivable	500,000	-
Investment in bank subsidiary, eliminated in consolidation	<u>17,077,384</u>	<u>16,126,245</u>
<b>Total assets</b>	<u>\$ 17,580,104</u>	<u>\$ 16,504,325</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Liabilities</b>		
Dividends payable	<u>500,000</u>	<u>375,000</u>
<b>Shareholders' Equity</b>		
Common stock, \$100 par value, 5,000 shares authorized, issued and outstanding	500,000	500,000
Capital surplus	500,000	500,000
Retained earnings	16,474,832	16,000,220
Accumulated other comprehensive income	<u>(394,728)</u>	<u>(870,895)</u>
<b>Total shareholders' equity</b>	<u>17,080,104</u>	<u>16,129,325</u>
<b>Total liabilities and shareholders' equity</b>	<u>\$ 17,580,104</u>	<u>\$ 16,504,325</u>

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b><u>Statements of Income</u></b>			
Income- dividend from bank subsidiary	\$ 500,000	\$ 375,000	\$ 375,000
Other expenses	360	420	-
Income before income taxes and undistributed income	499,640	374,580	375,000
Applicable income tax benefit (expense)	-	-	-
Income before undistributed income	499,640	374,580	375,000
Equity in undistributed net income of bank subsidiary	474,972	697,099	842,304
<b>Net Income</b>	<b>\$ 974,612</b>	<b>\$ 1,071,679</b>	<b>\$ 1,217,304</b>
	<b><u>2017</u></b>	<b><u>2016</u></b>	<b><u>2015</u></b>
<b><u>Statements of Cash Flows</u></b>			
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 974,612	\$ 1,071,679	\$ 1,217,304
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net income of subsidiary	(474,972)	(697,099)	(842,304)
(Decrease) in accounts receivable	(500,000)	-	-
Increase in dividends payable	125,000	-	-
<b>Net cash provided by operating activities</b>	<b>124,640</b>	<b>374,580</b>	<b>375,000</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Dividends paid to shareholders	(500,000)	(375,000)	(375,000)
<b>Net cash (used in) financing activities</b>	<b>(500,000)</b>	<b>(375,000)</b>	<b>(375,000)</b>
Increase (decrease) in cash	(375,360)	(420)	-
Cash:			
Beginning	378,080	378,500	378,500

## CORNERSTONE FINANCIAL SERVICES, INC. AND SUBSIDIARY

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Cornerstone Financial Services, Inc. accounts for its investment in its bank subsidiary by the equity method. During the years ended December 31, 2017, 2016 and 2015, changes were as follows:

Number of shares owned-Cornerstone Bank, Inc.	5,000
Percentage of shares owned-Cornerstone Bank, Inc.	100%
<b>Balance at December 31, 2014</b>	<b>\$ 15,578,350</b>
Add (deduct):	
Equity in net income	1,217,304
Dividends declared by subsidiary	(375,000)
Change in fair value of interest rate swap	(35,335)
Change in equity in net unrealized gain (loss) on securities	<u>(229,055)</u>
<b>Balance at December 31, 2015</b>	<b>16,156,264</b>
Add (deduct):	
Equity in net income	1,072,099
Dividends declared by subsidiary	(375,000)
Change in fair value of interest rate swap	34,813
Change in equity in net unrealized gain (loss) on securities	<u>(761,931)</u>
<b>Balance at December 31, 2016</b>	<b>16,126,245</b>
Add (deduct):	
Equity in net income	974,972
Dividends declared by subsidiary	(500,000)
Change in fair value of interest rate swap	22,155
Change in equity in net unrealized gain (loss) on securities	<u>454,012</u>
<b>Balance at December 31, 2017</b>	<b><u>\$ 17,077,384</u></b>