COMMUNITY WEST BANCSHARES /
Form 10-Q
August 01, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q
(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2016 or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to _________

Commission File Number: 000-23575

COMMUNITY WEST BANCSHARES
(Exact name of registrant as specified in its charter)

California	77-0446957
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

445 Pine Avenue, Goleta, California	93117
(Address of principal executive offices)	(Zip Code)

(805) 692-5821
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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

Common stock of the registrant issued and outstanding of 8,097,975 as of July 29, 2016.

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The financial statements included in this Form 10-Q should be read in conjunction with Community West Bancshares' Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

COMMUNITY WEST BANCSHARES
CONSOLIDATED BALANCE SHEETS

	June 30, 2016 (unaudited)	December 31, 2015
	(in thousands, except share amounts)	
Assets:		
Cash and due from banks	$ 2,646	$ 2,768
Federal funds sold	19	21
Interest-earning demand in other financial institutions	24,504	32,730
Cash and cash equivalents	27,169	35,519
Money market investments	100	99
Investment securities - available-for-sale, at fair value; amortized cost of $23,952 at June 30, 2016 and $23,558 at December 31, 2015	24,008	23,441
Investment securities - held-to-maturity, at amortized cost; fair value of $7,171 at June 30, 2016 and $7,399 at December 31, 2015	6,774	7,025
Federal Home Loan Bank stock, at cost	2,070	1,886
Federal Reserve Bank stock, at cost	1,373	1,373
Loans:		
Held for sale, at lower of cost or fair value	60,086	64,488
Held for investment, net of allowance for loan losses of $7,028 at June 30, 2016 and $6,916 at December 31, 2015	504,740	472,058
Total loans	564,826	536,546
Other assets acquired through foreclosure, net	129	198
Premises and equipment, net	2,888	2,993
Other assets	13,287	12,133
Total assets	$ 642,624	$ 621,213
Liabilities:		
Deposits:		
Non-interest-bearing demand	$ 83,524	$ 76,469
Interest-bearing demand	250,036	250,509
Savings	14,173	13,690
Certificates of deposit ($250 or more)	74,622	66,722
Other certificates of deposit	142,829	136,948
Total deposits	565,184	544,338
Other borrowings	10,500	10,500
Other liabilities	3,702	4,431
Total liabilities	579,386	559,269
Stockholders’ equity:		
Common stock — no par value, 20,000,000 shares authorized; 8,097,975 shares issued and outstanding at June 30, 2016 and 8,205,858 at December 31, 2015	41,670	42,355
Retained earnings	21,535	19,657
Accumulated other comprehensive income (loss)	33	(68)
Total stockholders’ equity	63,238	61,944

Total liabilities and stockholders’ equity	$ 642,624	$ 621,213

See the accompanying notes.

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COMMUNITY WEST BANCSHARES
CONSOLIDATED INCOME STATEMENTS (unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Interest income:	(in thousands, except per share amounts)			
Loans, including fees	$ 7,414	$ 7,410	$ 14,589	$ 14,122
Investment securities and other	260	285	529	590
Total interest income	7,674	7,695	15,118	14,712
Interest expense:				
Deposits	704	569	1,355	1,174
Other borrowings	73	15	145	76
Total interest expense	777	584	1,500	1,250
Net interest income	6,897	7,111	13,618	13,462
Provision (credit) for loan losses	61	(584)	(186)	(1,552)
Net interest income after provision for loan losses	6,836	7,695	13,804	15,014
Non-interest income:				
Other loan fees	282	370	557	545
Document processing fees	136	131	251	223
Service charges	102	87	192	160
Other	57	149	156	289
Total non-interest income	577	737	1,156	1,217
Non-interest expenses:				
Salaries and employee benefits	3,494	3,202	6,946	6,317
Occupancy, net	581	487	1,067	932
Professional services	278	276	457	524
Data processing	169	134	340	253
Depreciation	175	96	324	187
FDIC assessment	99	82	196	153
Advertising and marketing	212	152	293	232
Stock-based compensation	84	218	164	260
Loan servicing and collection	(89)	182	90	271
Loan litigation settlement, net	—	7,153	—	7,153
Other	503	399	965	870
Total non-interest expenses	5,506	12,381	10,842	17,152
Income (loss) before provision for income taxes	1,907	(3,949)	4,118	(921)
Provision (benefit) for income taxes	782	(1,607)	1,710	(349)
Net income (loss)	1,125	(2,342)	2,408	(572)
Dividends on preferred stock	—	136	—	276
Discount on partial redemption of preferred stock	—	(110)	—	(129)
Net income (loss) available to common stockholders	$ 1,125	$ (2,368)	$ 2,408	$ (719)
Earnings (loss) per share:				
Basic	$ 0.14	$ (0.29)	$ 0.30	$ (0.09)
Diluted	$ 0.13	$ (0.29)	$ 0.29	$ (0.09)
Weighted average number of common shares outstanding:				
Basic	8,098	8,204	8,134	8,204
Diluted	8,410	8,204	8,439	8,204
Dividends declared per common share	$ 0.035	$ 0.03	$ 0.065	$ 0.05

See the accompanying notes.

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COMMUNITY WEST BANCSHARES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Net income (loss)	$ 1,125	$ (2,342)	$ 2,408	$ (572)
Other comprehensive income (loss), net:				
Unrealized income (loss) on securities available-for-sale (AFS), net (tax effect of $11, $97, ($71) and $107 for each respective period)	(16)	(139)	101	(153)
Net other comprehensive income (loss)	(16)	(139)	101	(153)
Comprehensive income (loss)	$ 1,109	$ (2,481)	$ 2,509	$ (725)

See the accompanying notes.

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COMMUNITY WEST BANCSHARES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (unaudited)

	Common Stock		Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
	Shares	Amount			
	(in thousands)				
Balance, December 31, 2015:	8,206	$42,355	$ (68)	$19,657	$ 61,944
Net income	—	—	—	2,408	2,408
Exercise of stock options	30	131	—	—	131
Stock based compensation	—	164	—	—	164
Common stock repurchases	(138)	(980)	—	—	(980)
Dividends on common stock	—	—	—	(530)	(530)
Other comprehensive income, net	—	—	101	—	101
Balance, June 30, 2016	8,098	$41,670	$ 33	$21,535	$ 63,238

See the accompanying notes.

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COMMUNITY WEST BANCSHARES

CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

	Six Months Ended June 30, 2016	2015
	(in thousands)	
Cash flows from operating activities:		
Net income (loss)	$ 2,408	$ (572)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Provision (credit) for loan losses	(186)	(1,552)
Depreciation	324	187
Stock based compensation	164	260
Deferred income taxes	(27)	177
Net accretion of discounts and premiums for investment securities	188	(70)
(Gains)/Losses on:		
Sale of repossessed assets, net	7	(17)
Sale of loans, net	—	(107)
Sale of assets, net	—	32
Loans originated for sale and principal collections, net	4,402	1,382
Changes in:		
Other assets	(1,197)	398
Other liabilities	(763)	(1,082)
Servicing rights, net	33	28
Net cash provided by (used in) operating activities	5,353	(936)
Cash flows from investing activities:		
Principal pay downs and maturities of available-for-sale securities	4,892	5,001
Purchase of available-for-sale securities	(5,472)	(7,416)
Proceeds from principal pay downs and maturities of securities held-to-maturity	248	926
Loan originations and principal collections, net	(32,661)	(24,676)
Purchase of restricted stock, net	(184)	(170)
Net increase in interest-bearing deposits in other financial institutions	(1)	—
Purchase of premises and equipment, net	(219)	(125)
Proceeds from sale of other real estate owned and repossessed assets, net	227	222
Net cash used in investing activities	(33,170)	(26,238)
Cash flows from financing activities:		
Net increase in deposits	20,846	23,513
Net increase in borrowings	—	10,000
Exercise of stock options	131	3
Cash dividends paid on common stock	(530)	(410)
Common stock repurchase	(980)	—
Redemption of preferred stock	—	(1,311)
Cash dividends paid on preferred stock	—	(292)
Net cash provided by financing activities	19,467	31,503
Net (decrease) increase in cash and cash equivalents	(8,350)	4,329
Cash and cash equivalents at beginning of year	35,519	18,959
Cash and cash equivalents at end of period	$ 27,169	$ 23,288
Supplemental disclosure:		
Cash paid during the period for:		
Interest	$ 1,422	$ 1,259

Income taxes	3,600	650
Non-cash investing and financing activity:		
Transfers to other assets acquired through foreclosure, net	165	335

See the accompanying notes.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Community West Bancshares (“CWBC”), incorporated under the laws of the state of California, is a bank holding company providing full service banking through its wholly-owned subsidiary Community West Bank, N.A. (“CWB” or the “Bank”). Unless indicated otherwise or unless the context suggest otherwise, these entities are referred to herein collectively and on a consolidated basis as the “Company.”

Basis of Presentation

The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States (“GAAP”) and conform to practices within the financial services industry. The accounts of the Company and its consolidated subsidiary are included in these Consolidated Financial Statements. All significant intercompany balances and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses and the fair value of securities available for sale. Although Management believes these estimates to be reasonably accurate, actual amounts may differ. In the opinion of Management, all necessary adjustments have been reflected in the financial statements during their preparation.

Interim Financial Information

The accompanying unaudited consolidated financial statements as of and for the three and six months ended June 30, 2016 and 2015 have been prepared in a condensed format, and therefore do not include all of the information and footnotes required by GAAP for complete financial statements. These statements have been prepared on a basis that is substantially consistent with the accounting principles applied to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2015.
The information furnished in these interim statements reflects all adjustments which are, in the opinion of management, necessary for a fair statement of the results for each respective period presented. Such adjustments are of a normal recurring nature. The results of operations in the interim statements are not necessarily indicative of the results that may be expected for any other quarter or for the full year. The interim financial information should be read in conjunction with the Company’s audited consolidated financial statements.

Reclassifications

Certain amounts in the consolidated financial statements as of December 31, 2015 and for the three and six months ended June 30, 2015 have been reclassified to conform to the current presentation. The reclassifications have no effect on net income, comprehensive income or stockholders’ equity as previously reported.

Loans Held For Sale

Loans which are originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value determined on an aggregate basis. Valuation adjustments, if any, are recognized through a valuation allowance by charges to lower of cost or fair value provision. Loans held for sale are mostly comprised of SBA and commercial agriculture. In the third quarter of 2015, the Company announced its exit from originating single family residential loans for sale. The Company did not incur any lower of cost or fair value provision in the three months ended June 30, 2016 and 2015.

Loans Held for Investment and Interest and Fees from Loans

Loans are recognized at the principal amount outstanding, net of unearned income, loan participations and amounts charged off. Unearned income includes deferred loan origination fees reduced by loan origination costs. Unearned income on loans is amortized to interest income over the life of the related loan using the level yield method.

Interest income on loans is accrued daily using the effective interest method and recognized over the terms of the loans. Loan fees collected for the origination of loans less direct loan origination costs (net deferred loan fees) are amortized over the contractual life of the loan through interest income. If the loan has scheduled payments, the amortization of the net deferred loan fee is calculated using the interest method over the contractual life of the loan. If the loan does not have scheduled payments, such as a line of credit, the net deferred loan fee is recognized as interest income on a straight-line basis over the contractual life of the loan commitment. Commitment fees based on a percentage of a customer’s unused line of credit and fees related to standby letters of credit are recognized over the commitment period.

When loans are repaid, any remaining unamortized balances of unearned fees, deferred fees and costs and premiums and discounts paid on purchased loans are accounted for through interest income.

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Nonaccrual loans: For all loan types, when a borrower discontinues making payments as contractually required by the note, the Company must determine whether it is appropriate to continue to accrue interest. Generally, the Company places loans in a nonaccrual status and ceases recognizing interest income when the loan has become delinquent by more than 90 days or when Management determines that the full repayment of principal and collection of interest is unlikely. The Company may decide to continue to accrue interest on certain loans more than 90 days delinquent if they are well secured by collateral and in the process of collection. Other personal loans are typically charged off no later than 180 days delinquent.

For all loan types, when a loan is placed on nonaccrual status, all interest accrued but uncollected is reversed against interest income in the period in which the status is changed. Subsequent payments received from the customer are applied to principal and no further interest income is recognized until the principal has been paid in full or until circumstances have changed such that payments are again consistently received as contractually required. The Company occasionally recognizes income on a cash basis for non-accrual loans in which the collection of the remaining principal balance is not in doubt.

Impaired loans: A loan is considered impaired when, based on current information; it is probable that the Company will be unable to collect the scheduled payments of principal and/or interest under the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and/or interest payments. Loans that experience insignificant payment delays or payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays or payment shortfalls on a case-by-case basis. When determining the possibility of impairment, management considers the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. For collateral-dependent loans, the Company uses the fair value of collateral method to measure impairment. The collateral-dependent loans that recognize impairment are charged down to the fair value less costs to sell. All other loans are measured for impairment either based on the present value of future cash flows or the loan’s observable market price.

Troubled debt restructured loan (“TDR”): A TDR is a loan on which the Company, for reasons related to the borrower’s financial difficulties, grants a concession to the borrower that the Company would not otherwise consider. These concessions included but are not limited to term extensions, rate reductions and principal reductions. Forgiveness of principal is rarely granted and modifications for all classes of loans are predominately term extensions. A TDR loan is also considered impaired. Generally, a loan that is modified at an effective market rate of interest may no longer be disclosed as a troubled debt restructuring in years subsequent to the restructuring if it is not impaired based on the terms specified by the restructuring agreement.

Allowance for Loan Losses and Provision for Loan Losses

The Company maintains a detailed, systematic analysis and procedural discipline to determine the amount of the allowance for loan losses (“ALL”). The ALL is based on estimates and is intended to be appropriate to provide for probable losses inherent in the loan portfolio. This process involves deriving probable loss estimates that are based on migration analysis and historical loss rates, in addition to qualitative factors that are based on management’s judgment. The migration analysis and historical loss rate calculations are based on the annualized loss rates utilizing a twelve-quarter loss history. Migration analysis is utilized for the Commercial Real Estate (“CRE”), Commercial, Commercial Agriculture, Small Business Administration (“SBA”), Home Equity Line of Credit (“HELOC”), Single Family Residential, and Consumer portfolios. The historical loss rate method is utilized primarily for the Manufactured Housing portfolio. The migration analysis takes into account the risk rating of loans that are charged off in each loan category. Loans that are considered Doubtful are typically charged off. The following is a description of the characteristics of loan ratings. Loan ratings are reviewed as part of our normal loan monitoring process, but, at a minimum, updated on an annual basis.

Outstanding – This is the highest quality rating that is assigned to any loan in the portfolio. These loans are made to the highest quality borrowers with strong financial statements and unquestionable repayment sources. Collateral securing these types of credits are generally cash deposits in the bank or marketable securities held in custody.

Good – Loans rated in this category are strong loans, underwritten well, that bear little risk of loss to the Company. Loans in this category are loans to quality borrowers with very good financial statements that present an identifiable strong primary source and good secondary source of repayment. Generally, these credits are well collateralized by good quality and liquid assets or low loan to value market real estate.

Pass - Loans rated in this category are acceptable loans, appropriately underwritten, bearing an ordinary risk of loss to the Company. Loans in this category are loans to quality borrowers with financial statements presenting a good primary source as well as an adequate secondary source of repayment. In the case of individuals, borrowers with this rating are quality borrowers demonstrating a reasonable level of secure income, a net worth adequate to support the loan and presenting a good primary source as well as an adequate secondary source of repayment.

Watch – Acceptable credit that requires a temporary increase in attention by management. This can be caused by declines in sales, margins, liquidity or working capital. Generally the primary weakness is lack of current financial statements and industry issues.

Special Mention - A Special Mention loan has potential weaknesses that require management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

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Substandard - A Substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. These loans have a well-defined weakness or weaknesses that jeopardize full collection of amounts due. They are characterized by the distinct possibility that the Company will sustain some loss if the borrower's deficiencies are not corrected.

Doubtful - A loan classified Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work to the advantage and strengthening of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

Loss - Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable loans is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this loan even though partial recovery may be realized in the future. Losses are taken in the period in which they are considered uncollectible.

The Company's ALL is maintained at a level believed appropriate by management to absorb known and inherent probable losses on existing loans. The allowance is charged for losses when management believes that full recovery on the loan is unlikely. The following is the Company's policy regarding charging off loans.

Commercial, CRE and SBA Loans

Charge-offs on these loan categories are taken as soon as all or a portion of any loan balance is deemed to be uncollectible. A loan is considered impaired when, based on current information, it is probable that the Company will be unable to collect the scheduled payments of principal and/or interest under the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and/or interest payments. Loans that experience insignificant payment delays or payment shortfalls generally are not classified as impaired. Generally, loan balances are charged-down to the fair value of the collateral, if, based on a current assessment of the value, an apparent deficiency exists. In the event there is no perceived equity, the loan is charged-off in full. Unsecured loans which are delinquent over 90 days are also charged-off in full.

Single Family Real Estate, HELOC's and Manufactured Housing Loans

Consumer loans and residential mortgages secured by one-to-four family residential properties, HELOC and manufactured housing loans in which principal or interest is due and unpaid for 90 days, are evaluated for impairment. Loan balances are charged-off to the fair value of the property, less estimated selling costs, if, based on a current appraisal, an apparent deficiency exists. In the event there is no perceived equity, the loan is generally fully charged-off.

Consumer Loans

All consumer loans (excluding real estate mortgages, HELOCs and savings secured loans) are charged-off or charged-down to net recoverable value before becoming 120 days or five payments delinquent.

The ALL calculation for the different loan portfolios is as follows:

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- Commercial Real Estate, Commercial, Commercial Agriculture, SBA, HELOC, Single Family Residential, and Consumer – Migration analysis combined with risk rating is used to determine the required ALL for all non-impaired loans. In addition, the migration results are adjusted based upon qualitative factors that affect this specific portfolio category. Reserves on impaired loans are determined based upon the individual characteristics of the loan.
- Manufactured Housing – The ALL is calculated on the basis of loss history and risk rating, which is primarily a function of delinquency. In addition, the loss results are adjusted based upon qualitative factors that affect this specific portfolio.

The Company evaluates and individually assesses for impairment loans classified as substandard or doubtful in addition to loans either on nonaccrual, considered a TDR or when other conditions exist which lead management to review for possible impairment. Measurement of impairment on impaired loans is determined on a loan-by-loan basis and in total establishes a specific reserve for impaired loans. The amount of impairment is determined by comparing the recorded investment in each loan with its value measured by one of three methods:

- The expected future cash flows are estimated and then discounted at the effective interest rate.
- The value of the underlying collateral net of selling costs. Selling costs are estimated based on industry standards, the Company's actual experience or actual costs incurred as appropriate. When evaluating real estate collateral, the Company typically uses appraisals or valuations, no more than twelve months old at time of evaluation. When evaluating non-real estate collateral securing the loan, the Company will use audited financial statements or appraisals no more than twelve months old at time of evaluation. Additionally, for both real estate and non-real estate collateral, the Company may use other sources to determine value as deemed appropriate.
- The loan's observable market price.

Interest income is not recognized on impaired loans except for limited circumstances in which a loan, although impaired, continues to perform in accordance with the loan contract and the borrower provides financial information to support maintaining the loan on accrual.

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The Company determines the appropriate ALL on a monthly basis. Any differences between estimated and actual observed losses from the prior month are reflected in the current period in determining the appropriate ALL determination and adjusted as deemed necessary. The review of the appropriateness of the allowance takes into consideration such factors as concentrations of credit, changes in the growth, size and composition of the loan portfolio, overall and individual portfolio quality, review of specific problem loans, collateral, guarantees and economic and environmental conditions that may affect the borrowers' ability to pay and/or the value of the underlying collateral. Additional factors considered include: geographic location of borrowers, changes in the Company's product-specific credit policy and lending staff experience. These estimates depend on the outcome of future events and, therefore, contain inherent uncertainties.

Another component of the ALL considers qualitative factors related to non-impaired loans. The qualitative portion of the allowance on each of the loan pools is based on the following factors:

- Concentrations of credit
- International risk
- Trends in volume, maturity, and composition
- Volume and trend in delinquency
- Economic conditions
- Outside exams
- Geographic distance
- Policy and changes
- Staff experience and ability

Off Balance Sheet and Credit Exposure

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded. They involve, to varying degrees, elements of credit risk in excess of amounts recognized in the consolidated balance sheets. Losses would be experienced when the Company is contractually obligated to make a payment under these instruments and must seek repayment from the borrower, which may not be as financially sound in the current period as they were when the commitment was originally made. 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 Company enters into credit arrangements that generally provide for the termination of advances in the event of a covenant violation or other event of default. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the party. The commitments are collateralized by the same types of assets used as loan collateral.

As with outstanding loans, the Company applies qualitative factors and utilization rates to its off-balance sheet obligations in determining an estimate of losses inherent in these contractual obligations. The estimate for loan losses on off-balance sheet instruments is included within other liabilities and the charge to income that establishes this liability is included in non-interest expense.

Foreclosed Real Estate and Repossessed Assets

Foreclosed real estate and other repossessed assets are recorded at fair value at the time of foreclosure less estimated costs to sell. Any excess of loan balance over the fair value less estimated costs to sell of the other assets is charged-off against the allowance for loan losses. Any excess of the fair value less estimated costs to sell over the loan balance is recorded as a loan loss recovery to the extent of the loan loss previously charged-off against the allowance for loan losses; and, if greater, recorded as a gain on foreclosed assets. Subsequent to the legal ownership date, the Company periodically performs a new valuation and the asset is carried at the lower of carrying amount or fair value less estimated costs to sell. Operating expenses or income, and gains or losses on disposition of such properties, are recorded in current operations.

Income Taxes

The Company uses the asset and liability method, which recognizes an asset or liability representing the tax effects of future deductible or taxable amounts that have been recognized in the consolidated financial statements. Due to tax regulations, certain items of income and expense are recognized in different periods for tax return purposes than for financial statement reporting. These items represent “temporary differences.” Deferred income taxes are recognized for the tax effect of temporary differences between the tax basis of assets and liabilities and their financial reporting amounts at each period end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. A valuation allowance is established for deferred tax assets if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets may not be realized. Any interest or penalties assessed by the taxing authorities is classified in the financial statements as income tax expense. Deferred tax assets are included in other assets on the consolidated balance sheets.

Management evaluates the Company’s deferred tax asset for recoverability using a consistent approach which considers the relative impact of negative and positive evidence, including the Company’s historical profitability and projections of future taxable income. The Company is required to establish a valuation allowance for deferred tax assets and record a charge to income if management determines, based on available evidence at the time the determination is made, that it is more likely than not that some portion or all of the deferred tax assets may not be realized.

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The Company is subject to the provisions of ASC 740, Income Taxes (“ASC 740”). ASC 740 prescribes a more likely than not threshold for the financial statement recognition of uncertain tax positions. ASC 740 clarifies the accounting for income taxes by prescribing a minimum recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. On a quarterly basis, the Company evaluates income tax accruals in accordance with ASC 740 guidance on uncertain tax positions.

Earnings Per Share

Basic earnings per common share is computed using the weighted average number of common shares outstanding for the period divided into the net income available to common shareholders. Diluted earnings per share include the effect of all dilutive potential common shares for the period. Potentially dilutive common shares include stock options and warrants.

Recent Accounting Pronouncements

In May 2014, the FASB issued guidance codified within ASU 2014-09, “Revenue Recognition - Revenue from Contracts with Customers,” which amends the guidance in former Topic 605, Revenue Recognition. The new revenue recognition standard will supersede virtually all revenue guidance in U.S. GAAP, including industry specific guidance. The guidance in this Update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards. ASU 2014-09 is effective for the Company for annual reporting periods beginning after December 15, 2016. In August 2015, this effective date was extended for the Company to December 15, 2017. The Company may elect to apply the amendments of this Update using one of the following two methods: 1) retrospectively to each prior reporting period presented or 2) retrospectively with the cumulative effect of initially applying this Update recognized at the date of initial application. The Company is currently evaluating the impact of the provisions in this standard on the Company’s consolidated financial statements.

In January 2016, the FASB issued guidance codified within ASU 2016-01, “Financial Instruments – Overall, Subtopic 825-10: Recognition and Measurement of Financial Assets and Financial Liabilities,” which amends certain guidance on classification and measurement of financial instruments. The update is intended to enhance the reporting model for financial instruments to provide users of financial instruments with more decision-useful information and addresses certain aspects of the recognition, measurement, presentation, and disclosure of financial instruments. ASU 2016-01 is effective for the Company for annual reporting periods beginning after December 15, 2017. The Company is currently evaluating the impact of the provisions in this standard on the Company’s consolidated financial statements.

In February 2016, the FASB amended its standards with respect to the accounting for leases. The amended guidance serves to replace all current U.S. GAAP guidance on this topic and requires that an operating lease be recognized on the statement of financial condition as a “right-to-use” asset along with a corresponding liability representing the rent obligation. Key aspects of current lessor accounting remain unchanged from existing guidance. This standard is expected to result in an increase to assets and liabilities recognized and, therefore, increase risk-weighted assets for regulatory capital purposes. The guidance requires the use of the modified retrospective transition approach for existing leases that have not expired before the date of initial application and will become effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The standard is effective for the Company as of January 1, 2019. The Company is currently evaluating the impact of the amended guidance on the Company’s Consolidated Financial Statements.

In March 2016, the FASB issued update guidance codified within ASU-2016-09, “Compensation – Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting,” which amends the guidance on certain aspects of share-based payments to employees. The new guidance will require entities to recognize all income tax effects of awards in the income statement when the awards vest or are settled. The guidance requires the use of the modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. The standard is effective for the Company as of January 1, 2017. The Company is currently evaluating the impact of the amended guidance on the Company's Consolidated Financial Statements.

In June of 2016, the FASB issued update guidance codified within ASU-2016-13, "Financial Instruments – Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments," which amends the guidance for recognizing credit losses from an "incurred loss" methodology that delays recognition of credit losses until it is probable a loss has been incurred to an expected credit loss methodology. The guidance requires the use of the modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. The standard is effective for the Company as of January 1, 2020. The Company is currently evaluating the impact of the amended guidance on the Company's Consolidated Financial Statements.

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2. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities are as follows:

	June 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Securities available-for-sale	(in thousands)			
U.S. government agency notes	$7,112	$ 70	$ (33)	$7,149
U.S. government agency collateralized mortgage obligations ("CMO")	16,774	77	(62)	16,789
Equity securities: Farmer Mac class A stock	66	4	-	70
Total	$23,952	$ 151	$ (95	