

UNITED STATES
OFFICE OF THE COMPTROLLER OF THE CURRENCY
WASHINGTON, D.C. 20219

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2011

or

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

For the transition period from _____ to _____

OCC Charter Number: 23616

VIRGINIA NATIONAL BANK

(Exact name of registrant as specified in its charter)

Virginia

(State or other jurisdiction of
incorporation or organization)

54-1902129

(I.R.S. Employer
Identification Number)

222 East Main Street, Charlottesville, Virginia

(Address of principal executive offices)

22902

(Zip Code)

Registrant's telephone number, including area code:

(434) 817-8621

Securities registered pursuant to 12(b) of the Act:

None

Securities registered pursuant to 12(g) of the Act:

Common Stock, par value \$2.50

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity as of June 30, 2011, the last business day of the registrant’s most recently completed second fiscal quarter.

\$29,810,734

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

2,690,220 shares as of March 23, 2012

Documents Incorporated by Reference

Portions of the following documents are hereby incorporated into Part I and Part III of this Form 10-K by reference: the Proxy Statement for the Annual Meeting of Shareholders to be held on May 21, 2012.

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Part I

In addition to historical information, the following Report contains forward looking statements that are subject to risks and uncertainties that could cause the Bank's actual results to differ materially from those anticipated. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of the Report.

Item 1. BUSINESS.

General

Virginia National Bank (the "Bank") was organized under federal law as a national banking association to engage in general commercial and retail banking business. The Bank received its charter from the Comptroller of the Currency and commenced operations on July 29, 1998. The Bank's deposits are insured to the maximum amount provided by the Federal Deposit Insurance Act by the Federal Deposit Insurance Corporation ("FDIC"). The Bank is subject to the supervision, examination and regulation of the Office of the Comptroller of the Currency ("OCC").

The Bank emphasizes serving the needs of owner-operated businesses, professional concerns and individuals in the Charlottesville/Albemarle County area, the Orange County area, and the Winchester area. The Bank offers a full range of banking and related financial services, including checking accounts, NOW accounts, money market deposit accounts, certificates of deposit, individual retirement accounts and other depository services. The Bank actively solicits such accounts from individuals, businesses, associations and other organizations within its trade area. The Bank also offers short-to-long term commercial, real estate and consumer loans. The Bank is committed to providing its customers with banking services comparable to those that larger regional and nationwide banks generally reserve for their larger clients. Such services include being a reliable and consistent source of credit, with loans that are priced based upon an overall banking relationship, easy access to the Bank's local decision makers who possess strong local market knowledge, local delivery, fast response, and continuity in the banking relationship.

Other services offered by Virginia National Bank include automated teller machines ("ATMs"), Internet banking, safe deposit boxes, travelers' checks, merchant card services, cash management services and direct deposit of payroll and federal recurring payments. In addition, the Bank is affiliated with Visa[®] which is accepted worldwide and offers debit cards to consumer and business customers.

In January, 2000, the Bank received regulatory approval from the OCC to open a Trust Department which began operations in the first quarter of 2000. On May 18, 2007, the Office of the Comptroller of the Currency ("OCC") granted approval to the Bank's application to establish a new national trust bank with the title VNBTrust, National Association ("VNBTrust"), which is now operating as a wholly-owned subsidiary of the Bank. Additionally, the OCC approved the Bank's application for VNBTrust to create a wholly-owned operating subsidiary, VNB Investment Management Company, LLC, a Delaware limited liability corporation, which has approval to organize and manage two private investment funds. One fund, known as Swift Run Capital, is in operation. In January, 2010, VNB Investment Management Company, LLC changed its name to Swift Run Capital Management, LLC.

Since July 29, 1998, the Bank has conducted business from its full-service main banking office located at 222 East Main Street in Charlottesville, Virginia. On March 15, 1999, a full-service

banking office was opened at 1580 Seminole Trail in Charlottesville, Virginia. On December 21, 1999, a full-service banking office was opened at 1900 Arlington Boulevard in Charlottesville, Virginia. On November 8, 2000, a full-service banking office was opened at 102 East Main Street in Orange, Virginia. On January 28, 2002, a full-service banking office was opened at 186 North Loudoun Street, Winchester, Virginia. On December 29, 2003, a full-service banking office was opened at 3119 Valley Avenue, #102, Winchester, Virginia. On April 28, 2008, a full-service banking office was opened at 404 People Place, Charlottesville, Virginia. Additionally, the multi-story office building houses the Bank's Operations Center and several administrative functions.

During 2006, the Trust Department relocated into leased space at 310 4th Street, NE, Suite 102, Charlottesville, Virginia where VNBTrust now conducts business.

Market Area

The market area served by Virginia National Bank continues to grow. According to the U.S. Census Bureau, the combined populations of the City of Charlottesville and Albemarle County stood at 142,445 persons as of April 1, 2010, an increase of approximately 14.6 percent between April 1, 2000 and April 1, 2010. The Charlottesville metropolitan statistical area ("MSA"), which includes Charlottesville, Albemarle County, Fluvanna County, Nelson County and Greene County, grew approximately 15.8 percent from 2000 to 2010, and is expected to grow over 12 percent to a population of 226,370 by 2020, according to the Virginia Employment Commission. Charlottesville and Albemarle County support a diverse, well-rounded economy. Stability in the local economy stems from the significant number of persons employed by the University of Virginia, as well as several service companies.

Orange County had a population of approximately 33,500 persons as of 2010. Between April 1, 2000 and April 1, 2010, its population grew 29.4 percent, compared to a 13.0 percent growth rate for the Commonwealth of Virginia as a whole.

The combined populations of the City of Winchester and Frederick County increased approximately 26.2 percent between April 1, 2000 and April 1, 2010, to a population of 104,510 persons in 2010.

Competition

The Bank engages in highly competitive activities. Each activity involves competition with other banks, as well as with non-banking enterprises that offer financial products and services that compete directly with the Bank's product and service offerings. The Bank actively competes with other banks in its efforts to obtain deposits and make loans, in the scope and types of services offered, in interest rates paid on time deposits and charged on loans, and in other aspects of banking.

In addition to competing with other commercial banks within and outside its primary service areas, the Bank competes with other financial institutions engaged in the business of making loans or accepting deposits, such as savings and loan associations, credit unions, insurance companies, small loan companies, finance companies, mortgage companies, certain governmental agencies and other enterprises. Competition for funds from securities brokers and mutual funds for money market accounts is strong. Additional competition for deposits comes from government and private issues of debt obligations and other investment alternatives for depositors such as money market funds.

The market areas served by Virginia National Bank are highly competitive with respect to banking. Competition for loans to small businesses and professionals is intense, and pricing is important. Many of the Bank's competitors have substantially greater resources and lending limits than the Bank and offer certain services such as extensive and established branch networks that the Bank does not expect to match. Deposit competition is also very strong. The Bank believes, however, that a market exists for the personal and customized financial services an independent, locally owned bank can offer.

Employees

At December 31, 2011, the Bank had 124 full time equivalent employees. None of its employees is represented by any collective bargaining unit. The Bank considers relations with its employees to be good.

The Bank has purchased Bank Owned Life Insurance ("BOLI") policies on executives and key personnel of the Bank. BOLI is a bank-eligible asset designed to recover costs of providing pre- and post-retirement benefits and/or to finance general employee benefit expenses. Under BOLI policies, the executives and other key personnel are the insured, and the Bank is the owner and beneficiary of the policies. The insured has no claim to the insurance policy or to the policy's cash value. Under separate split dollar agreements, a portion of any death benefit may be paid to the beneficiaries of the insured employees, subject to the terms and restrictions of the split dollar endorsement agreement between the officer and the Bank.

Bank-owned life insurance (BOLI) earnings of \$596,000 for 2011 represented an increase of \$385,000 over the total of \$211,000 for 2010. The increase in the year-over-year comparison came mostly from a death benefit received in December 2011, and the remainder was due to increased earnings from additional policies purchased in 2011.

Supervision and Regulation

The Bank is subject to supervision by the OCC, and is affected by the various applicable federal and Virginia laws, and regulations of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the FDIC. The various laws and regulations administered by these regulatory agencies affect corporate practices, expansion of business and provision of services. Also, monetary and fiscal policies of the United States directly affect bank loans and deposits and, thus, may affect the Bank's earnings. The OCC conducts regular examinations of the Bank, reviewing such matters as the quality of loans and investments, the adequacy of loan loss reserves, compliance with laws and regulations, management practices and other aspects of the Bank's operations. In addition to these regular examinations, the Bank must furnish periodic reports to regulatory agencies that contain a full and accurate statement of its affairs.

VNB opted not to participate in the Troubled Asset Relief Program ("TARP"). TARP was a program of the United States government to purchase assets and equity from financial institutions, and was the largest component of the federal government's measures in 2008 to promote financial market stability. Any publicly traded financial institution that accepted TARP funds must have provided the U.S. Treasury with warrants for the right to receive nonvoting common stock or preferred stock in such financial institution, or voting stock, with respect to which the Secretary of the Treasury agreed not to exercise voting power, as the Secretary determined appropriate. The terms and conditions of such warrant must have provided for reasonable participation by the Secretary in equity appreciation of such financial institution. The warrant must also have contained

anti-dilution provisions to protect the value of the securities from market transactions such as stock splits, stock distributions, dividends, and mergers. Other conditions for TARP recipients, such as executive compensation limits, have been imposed. VNB determined that its capital position and its strong credit quality made the acceptance of TARP funds unnecessary and not in the best interest of its shareholders.

In response to the most recent financial crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was passed on July 21, 2010. The Act will have a major impact on compliance for financial institutions. Many of the changes will not be implemented until 2012 or later. Additionally, most of the regulations that will be passed to implement the Act will not be finalized or become effective until 2012. The Act created a Consumer Financial Protection Bureau which has responsibility for most consumer protection laws and is a new regulatory entity associated with the Federal Reserve System. The new agency has supervisory and examination responsibility for large depository institutions with assets over \$10 billion and for non-bank mortgage industry participants. Due to the asset size of the Bank, the OCC will continue to be the primary regulator for supervision and examinations of VNB.

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 temporarily increased the FDIC deposit insurance from \$100,000 to \$250,000 per insured depositor, as defined by law and regulation. With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the increase to \$250,000 per insured depositor was made permanent. Additionally, the Dodd-Frank Wall Street Reform and Consumer Protection Act contained provisions that provide unlimited FDIC deposit insurance for certain noninterest-bearing transaction accounts. This coverage will be provided from December 31, 2010 through December 31, 2012. Accounts commonly known as Interest on Lawyers Trust Accounts (IOLTAs) will also be covered by this unlimited insurance through December 31, 2012.

The FDIC assesses deposit insurance premiums on all banks in order to adequately fund the Deposit Insurance Fund (“DIF”) so as to resolve any insured institution that is declared insolvent by its primary regulator. The FDIC has established a risk-based deposit insurance premium system to calculate a depository institution’s quarterly deposit insurance assessment. A prepayment of the FDIC premium through the fourth quarter of 2012 was collected on December 30, 2009. Effective April 1, 2011, the FDIC adopted changes to the deposit insurance assessment base, assessment rate adjustments, deposit insurance assessment rates, and large bank pricing methodology. Many of these changes were made as a result of provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act with the goal of “maintaining a positive fund balance even during a banking crisis and maintaining moderate, steady assessment rates throughout economic and credit cycles.” While the base of deposit insurance assessments previously was based on deposit totals, one of the major changes was to change the base of deposit insurance assessments to the average consolidated total assets during the assessment period less average tangible equity capital.

Virginia National Bank is designated as an established small insured depository institution. Small banks (those with less than \$10 billion in assets) are divided into four risk categories based on their confidential composite CAMELS regulatory rating and level of capital. A Risk Category I bank represents lower risk to the insurance system, while a Risk Category IV bank represents higher risk. Because of its confidential composite CAMELS rating and capital levels, Virginia National Bank is designated as a Risk Category I bank. Small banks in Risk Category I are evaluated, and their premiums are set, based on a combination of financial ratios and supervisory ratings. The financial ratios are as follows:

- Tier I leverage ratio;
- Loans past due 30 – 89 days, as a percentage of gross assets;
- Nonperforming assets, as a percentage of gross assets;
- Net loan charge-offs, as a percentage of gross assets; and
- Net income before taxes, as a percentage of risk-weighted assets.

Supervisory ratings will also be taken into account using a weighted average of an institution's confidential CAMELS component ratings.

Safety and Soundness Standards

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (“FIRREA”) expanded the OCC’s authority to prohibit activities of banks which represent unsafe and unsound banking practices or which constitute violations of laws or regulations. Notably, FIRREA increased the amount of civil money penalties that the OCC can assess for certain activities conducted on a knowing and reckless basis, if those activities cause a substantial loss to a depository institution. The penalties can be as high as \$1 million per day. FIRREA also expanded the scope of individuals and entities against which such penalties may be assessed.

On July 10, 1995, the four federal agencies that regulate banks and savings associations (FDIC, Federal Reserve Board, OCC and the Office of Thrift Supervision) jointly issued guidelines for safe and sound banking operations (“Interagency Guidelines Establishing Standards for Safety and Soundness”) as required by Section 132 of the Federal Deposit Insurance Corporation Improvement Act (“FDICIA”). The guidelines identify the fundamental standards that the agencies follow when evaluating the operational and managerial controls at insured institutions. An institution’s performance will be evaluated against these standards during the regulators’ periodic on-site examinations.

Lending Activities

The Bank offers credit facilities, both secured and occasionally unsecured, to business customers. These facilities include term loans, single payment loans, revolving credit facilities and other lines of credit. These loans may be for temporary or seasonal working capital needs, or to provide funding for the acquisition of fixed assets or real estate. In addition, the Bank offers commercial real estate construction loans for both investment properties and owner-occupants of business facilities.

Installment loans, consumer purpose loans, revolving lines of credit and home equity lines of credit are also offered by the Bank.

The Bank’s lending activities are subject to a variety of lending limits imposed by federal law and internal policy. While differing limits apply in certain circumstances based on the type of loan or the nature of the borrower, the Bank is generally subject to a loan-to-one-borrower limit in an amount equal to fifteen percent of the Bank's capital and surplus. Loans which are fully secured by readily marketable or other permissible types of collateral may exceed the fifteen percent limitation. Although the Bank’s capitalization has enabled it to have a lending limit that satisfies the credit needs of a large portion of its target market, the Bank has also established relationships with correspondent banks to participate in loans when the amounts exceed the Bank’s legal lending limit or the more stringent limits imposed by internal lending policies.

Credit Policies

The Bank employs a written credit policy to enhance its management of credit risk. The policy includes underwriting guidelines, principles of loan analysis, documentation requirements, maintenance guidelines for credit files, risk assessment rules and definitions, and procedures for ongoing identification and management of loans of less than acceptable risk. The policy also fixes the lending limits of all lending personnel for both secured and unsecured lending. Loans in excess of this amount require consideration by and approval of the Bank's Loan Committee, which meets at least once per week. The Bank places an extremely high value on the confidentiality of any customer information. The credit policy also addresses items such as aggregate loan diversification, conflicts of interest, loan pricing, concentrations of credit and the impact of business cycles on loan philosophy.

Community Reinvestment Act

The Community Reinvestment Act of 1977 ("CRA"), and the regulations promulgated by the OCC to implement CRA, are intended to ensure that banks meet the credit needs of their service area, including low and moderate income communities and individuals, consistent with safe and sound banking practices. In 1995, the bank regulatory agencies adopted final regulations for implementing CRA. The CRA regulations require the banking regulatory authorities to evaluate a bank's record in meeting the needs of its service area when considering applications to establish new offices or consummate any merger or acquisition transaction. Under FIRREA, the federal banking agencies are required to rate each insured institution's performance under CRA and to make such information publicly available. In the case of an acquisition by a bank holding company, the CRA performance record of the banks involved in the transaction are reviewed as part of the processing of the acquisition application. A CRA rating other than 'outstanding' or 'satisfactory' can substantially delay or block the transaction. The Bank was last examined under the Community Reinvestment Act during 2009 and expects its next CRA examination by the end of 2012.

Consumer Laws and Regulations

Banks are also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks. Among the more prominent of such laws and regulations are the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, and the Fair Housing Act. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. The Bank must comply with the applicable provisions of these consumer protection laws and regulations as part of its ongoing customer relations.

The Financial Services Modernization Act of 1999

The Financial Services Modernization Act of 1999, more commonly known as The Gramm-Leach-Bliley Act ("Act"), was signed into law on November 12, 1999. The 1933 Glass-Steagall Act's prohibitions on affiliations between banks and securities companies were repealed, as were the 1956 Bank Holding Company Act's prohibitions on affiliations between banks and insurance companies. Bank holding companies and foreign banks that meet certain eligibility criteria may become 'financial holding companies,' allowed to engage in any non-financial activity that the

Federal Reserve Board determines is complementary to a financial activity and that does not pose a substantial risk to the safety or soundness of depository institutions or the financial system.

In addition, the Act requires all financial institutions, regardless of whether they form a financial holding company, to disclose to consumer customers their policies and practices for protecting the privacy of non-public personal information. The Act prohibits a financial institution from disclosing to non-affiliated third parties any non-public information about a consumer customer, unless the institution both informs the customer that such information may be shared with third parties and allows the customer to opt out of such sharing arrangements.

Dividend Restrictions

The amount of dividends payable by the Bank will depend on its earnings and capital position, and is limited by federal law, regulations and policy. No dividend may be declared or paid that would impair a bank's paid-in capital. Additionally, the OCC has the general authority to limit dividends paid by the Bank if such payments are deemed to constitute an unsafe and unsound practice.

Under current supervisory practice, prior approval of the OCC is required if cash dividends declared in any year exceed the total of a bank's net profits for such year, plus its retained net profits for the preceding two years. Also, the Bank may not pay a dividend greater than its undivided profits then on hand after deducting current losses and bad debts. Federal law further provides that no insured depository institution may make any capital distribution, including a cash dividend, if the institution would not satisfy one or more of its minimum capital requirements after making such distribution.

Code of Ethics

VNB has adopted a Code of Ethics that applies to all of its employees, including its principal executive officer and its principal financial officer. The Code of Ethics is designed to deter wrongdoing and to promote the following:

1. Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships.
2. Full, fair, accurate, timely and understandable disclosure in reports and documents that are filed with regulatory agencies and in other public communications.
3. Compliance with applicable governmental laws, rules and regulations.
4. The prompt internal reporting of violations of the code to an appropriate person identified in the code.
5. Accountability for adherence to the code.

Availability of Information

The Bank files its periodic and annual reports with the Office of the Comptroller of the Currency. Our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, plus any amendments to these reports, are available, free of charge, on the Bank's Internet website

at www.vnb.com. These reports are available as soon as reasonably practical after they are filed with the OCC.

Item 1A. RISK FACTORS.

Not required

Item 2. PROPERTIES.

The Bank currently occupies eight sites in Charlottesville, Winchester and Albemarle and Orange Counties. The main office and a full-service banking facility are located at 222 East Main Street, Charlottesville, Virginia. Full-service banking facilities are also located at 1580 Seminole Trail, Charlottesville, Virginia; 1900 Arlington Boulevard, Charlottesville, Virginia; 102 East Main Street, Orange, Virginia; 186 North Loudoun Street, Winchester, Virginia; 3119 Valley Avenue, #102, Winchester, Virginia; and 404 People Place, Charlottesville, Virginia. As of December 31, 2011, all of the full-service banking locations were leased as described further below.

VNBTrust leases space at 310 4th Street, NE, Suite 102, Charlottesville, Virginia.

Lease terms for the above-mentioned properties are as follows:

222 East Main Street, Charlottesville, VA (Downtown Mall Office):

This property was originally leased from Williams Pentagram Corporation in 1998, and is currently in the fourth year of a five-year renewal term. The lease provides for three more five-year renewal options.

1900 Arlington Boulevard, Charlottesville, VA (Barracks Road Office):

This property was leased in 1998 from Paul and Jean Holdren for a term of twenty years with seven five-year renewal options. The Arlington Boulevard site has additional space not occupied by the banking facility. All but one unit of this space has been leased, and the Bank is actively seeking a new tenant.

1580 Seminole Trail, Charlottesville, VA (29 North Office):

This property was leased in 1998 from Sunny Hill Land Trust (an entity in which Hunter Craig, a director of the Bank, holds a beneficial interest) for a term of five years with six five-year renewal options. In 2008, the Bank exercised the second five-year renewal option. Monthly rent for this space was a fair market rate as verified by an independent third-party appraisal. In the first quarter of 2012, the Bank purchased the property from Sunny Hill Land Trust, thus terminating the lease.

102 East Main Street, Orange, VA (Orange Office):

This property was leased in 2000 from The Bryant Foundation for a term of three years with three five-year renewal options. The Bank has exercised the second five-year renewal option. The Bank entered a new five-year lease in January, 2011 for additional space on the second floor, where the Bank houses its Disaster Recovery site and some other operational office space. This lease has three two-year renewal options.

186 North Loudoun Street, Winchester, VA (Winchester Office):

This property was originally leased in 2001 from Shenandoah University for a term of ten years with two five-year renewal options. In 2011, the Bank and Shenandoah University entered a new lease for this property for a term of five years with one five-year renewal term.

3119 Valley Avenue, #102, Winchester, VA (Creekside Office):

This property is located in the Creekside Station Shopping Center. It was leased in 2003 from Joleen, L.C. for a term of ten years expiring January 31, 2014, with two five-year renewal options.

404 People Place, Charlottesville, VA (Pantops Park Office):

This property, consisting of approximately 8,167 square feet, is located just east of the Charlottesville city limits on Pantops Mountain, and fronts on Route 250 East. The building was constructed by the Bank on a pad site leased in 2005 from Pantops Park, LLC for a term of twenty years, with seven five-year renewal options. William D. Dittmar, Jr., a director of the Bank, is the sole managing member of Pantops Park, LLC. Monthly rent for this space is a fair market rate as verified by an independent third-party appraisal. A five-story building, consisting of approximately 43,000 square feet, was completed in early 2008, and the Bank opened this full-service office in April, 2008. Additionally, the building houses the Bank's Operations Center and several administrative functions. It also contains space for lease to third parties. A portion of the space has been rented, and the Bank is actively seeking other tenants.

310 4th Street, N.E., Suite 102, Charlottesville, VA (VNBTrust, N.A.):

This property is located approximately two blocks from the downtown Charlottesville banking office. It was leased in 2006 from Court Square, L.L.C. for a term of five years, with two five-year renewal options. The lease was amended effective December 20, 2010 to extend the lease until July 31, 2016 and to provide for an additional five-year renewal term with slightly reduced payment terms.

Item 3. LEGAL PROCEEDINGS.

There are no legal proceedings against the Bank that would have a material adverse effect on the Bank or its financial condition.

Item 4. MINE SAFETY DISCLOSURES.

Not applicable

Part II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Virginia National Bank's Common Stock is listed on the National Association of Securities Dealers Over-the-Counter Bulletin Board (OTCBB), an inter-dealer quotation system for equity securities

not listed on the NASDAQ Stock Market, under the symbol VABK. As of December 31, 2011, the Bank had issued and outstanding 2,690,220 shares of Common Stock. These shares were held by approximately 583 shareholders of record and others who held shares at brokerage firms. The Bank's Common Stock was issued on June 26, 1998, at a price of \$10.00 per share.

On May 16, 2011, the Board of Directors declared a 15% stock dividend. The stock dividend was paid on June 30, 2011 to shareholders of record at the close of business on June 15, 2011. As a result of the stock dividend, each shareholder received 0.15 shares of Common Stock for every share of Common Stock held as of the record date. The Bank has not declared any cash dividends. Payments of dividends is at the discretion of the Bank's Board of Directors, is subject to various federal and state regulatory limitations, and is dependent upon the overall performance and capital requirements of the Bank.

For the years ended December 31, 2011 and December 31, 2010, the performance of the Common Stock was as follows:

	2011		2010	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
First Quarter	\$19.57	\$13.04	\$16.09	\$12.83
Second Quarter	\$20.87	\$14.35	\$20.43	\$15.61
Third Quarter	\$18.50	\$13.10	\$19.12	\$11.30
Fourth Quarter	\$17.40	\$12.25	\$13.91	\$11.52

Per share information for all periods have been restated to reflect the 1.15 to 1 stock dividend paid on June 30, 2011.

American Stock Transfer and Trust Company is the Bank's stock transfer agent and registrar.

Item 6. SELECTED FINANCIAL DATA.

Not required

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF CONSOLIDATED FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion provides information about the major components of the results of consolidated operations and financial condition, liquidity and capital resources of Virginia National Bank. This discussion and analysis should be read in conjunction with the *Consolidated Financial Statements* and *Notes to the Consolidated Financial Statements*.

Critical Accounting Policies

General

The Bank's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could

affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. We use historical loss factors as one factor in determining the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from the historical factors that we use. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

The Bank adopted Accounting Standards Codification (“ASC”) 105, “The FASB Accounting Standards Codification and Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement 162” (ASC 105) during the third quarter of 2009. This guidance established ASC as the single source of authoritative U.S. GAAP recognized by the Financial Accounting Standards Board (“FASB”) to be applied by nongovernmental entities, except for rules and interpretive releases of the Securities and Exchange Commission (“SEC”).

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that may be sustained in our loan portfolio. The allowance is based on two basic principles of accounting: (i) ASC 450, “Contingencies,” which requires that losses be accrued when they are probable of occurring and estimatable, and (ii) ASC 310, “Receivables,” which requires that losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

In general, banks determine the adequacy of their allowance for loan losses by considering the risk classification and delinquency status of loans and other factors. A bank’s management may also establish specific allowances for loans which management believes require allowances greater than those allocated according to their risk classification. The purpose of the allowance is to provide for potential losses inherent in the loan portfolio. Since risks to the loan portfolio include general economic trends as well as conditions affecting individual borrowers, the allowance is an estimate.

Non-GAAP Presentations

The Bank, in referring to its net income, is referring to income under accounting principles generally accepted in the United States of America, or “GAAP”. This management’s discussion and analysis also refers to the efficiency ratio which is computed by dividing non-interest expense by the sum of net interest income and non-interest income. This is a non-GAAP financial measure which may provide important information concerning the Bank’s operational efficiency. Comparison of our efficiency ratio with those of other companies may not be possible because other companies may calculate the efficiency ratio differently.

Net Income

The net income for the period ended December 31, 2011 was \$2,341,000, compared to \$4,030,000 for the period ended December 31, 2010. The commercial bank earned net income of \$2,008,000 in 2011, the second highest earnings year for the commercial bank since opening in 1998. In 2010, the commercial bank earned \$1,941,000. VNBTrust, N.A. earned net income of \$333,000 in 2011, compared to net income of \$2,089,000 for 2010. In 2010, record performance fees for VNBTrust contributed \$2.0 million to net income. All other income streams in 2011 netted an increase over 2010.

The \$1,689,000 decrease in net income in 2011 from 2010 is attributable to a \$617,000 decrease in net interest income, a \$221,000 increase in provision for loan loss, and a \$2,698,000 decrease in non-interest income. Income was positively impacted by a \$709,000 decrease in non-interest expense and a \$1,138,000 decrease in income taxes.

For the first and second quarters of 2011, the Bank had net income of \$289,000 and \$285,000. During the third and fourth quarters of 2011, the Bank achieved net income of \$734,000 and \$1,033,000.

Net Interest Income

Net interest income is the major component of a bank's earnings, and represents the amount by which interest income exceeds interest expense. Variables that may have an impact on net interest income are market interest rates and the mix and volume of earning assets and interest-bearing liabilities. The management of the Bank strives to maximize net interest income through prudent balance sheet administration, while maintaining appropriate risk levels as determined by the Bank's Board of Directors. During 2011, net interest income was \$16,075,000 compared to \$16,692,000 for 2010. The \$617,000 variance in net interest income year to year is mainly attributed to interest rate compression during this period of historically low interest rates and the mix of earning assets. Despite higher average deposits funding additional earning assets of \$32.0 million during 2011 versus 2010, a decline in loan demand and loan runoff negatively impacted net interest income and the net interest margin. Average loans for the year ended December 31, 2011 were \$12.1 million less than for the year ended December 31, 2010.

The net interest margin, defined as net interest income expressed as a percentage of average earning assets, was 3.73% in 2011, compared to 4.18% during 2010. The Bank's Prime Rate, representing the interest rate paid by the Bank's most creditworthy customers, was lowered to 3.25% in December, 2008, and has remained unchanged. Another factor that affects the Bank's net interest margin is the mix between non-interest bearing and interest-bearing deposits. A continuing positive influence on the Bank's net interest margin is the Bank's level of non-interest bearing demand deposits, which averaged 27.1% of total deposits for the year.

Provision for Loan Losses

The provision for loan losses is affected by the net growth of the loan portfolio, the level of any charge-offs or recoveries, and the consideration of the risk classification and delinquency status of its loans. Since the Bank opened for business on July 29, 1998, it has accumulated data on which to base a realistic reserve against any problem loans that might arise in its portfolio. At present, the Bank has determined that an allowance for loan losses at 1.28% of outstanding loans is adequate. As any future problem loan data is accumulated and analyzed, the Bank may set aside more or less than 1.28%, and reallocate the allowance by category, such that it reflects a more accurate indication of management's estimate of future potential losses. Additional information concerning management's methodology in determining the adequacy of the allowance for loan losses is contained in Note 4 of the *Notes to the Consolidated Financial Statements*.

The Bank increased its allowance to total loans outstanding to 1.28% by year-end 2011, compared to the 1.25% required at year-end 2010. The Bank realized a provision expense in 2011 of \$535,000, compared to a provision expense of \$314,000 in 2010. There were \$560,000 in charged off loans for year 2011, with recoveries of \$36,000. \$426,000 of the 2011 charge-offs were related to one customer. There were \$435,000 in charged off loans for year 2010, with recoveries of

\$119,000. Net charge-offs to average loans remained strong at 0.18% for 2011 and 0.10% for 2010.

Non-Interest Income

Total non-interest income for the year ended December 31, 2011 was \$5,106,000, down significantly over non-interest income of \$7,804,000 for the year ended December 31, 2010. The main component of this decrease was trust income of \$2,588,000 for 2011, as compared to \$5,611,000 in 2010. VNBTrust revenue comes predominately from two sources: fixed fees, which are based on the market value of client assets under management, and performance fees, which are based on the investment returns produced by VNBTrust for its clients. Fixed fees increased 20.8% to \$2,214,000 in 2011 from \$1,833,000 in 2010. As discussed previously, record performance fees in 2010 were not sustained in 2011. Performance-based fees were \$438,000 in 2011, compared to \$4,735,000 in 2010. According to a pre-established formula, VNBTrust staff are compensated on the level of profits earned. In all applicable prior years, this compensation was paid solely in cash. In 2011 and 2010, however, incentive compensation of \$74,000 and \$1,013,000, respectively, was distributed in the form of carried interest in Swift Run Capital, as allowed by IRS regulations. The payment method had the effect of lowering both non-interest income and non-interest expense by that same amount, as ultimately reflected in the Bank's financial reports. Other trust income collected in 2011 was \$10,000 as compared to \$56,000 in 2010.

Bank-owned life insurance (BOLI) earnings of \$596,000 for 2011 represented an increase of \$385,000 over the total of \$211,000 for 2010. \$358,000 of this increase came from a death benefit received in late 2011, and the remainder was due to increased earnings on additional policies purchased in 2011 on key officers.

Non-Interest Expense

Total non-interest expense for the year ended December 31, 2011 was \$17.4 million, compared to \$18.1 million for the year ended December 31, 2010. The primary components of 2011 non-interest expense were salaries and employee benefits of \$9,526,000, net occupancy expenses of \$2,324,000, equipment expenses of \$988,000, third party processing of \$742,000, marketing, advertising, and promotional expenses of \$620,000 and an assortment of other expenses totaling \$3,173,000.

Personnel expenses for 2011 of \$9,526,000 were down \$127,000 from \$9,653,000 in 2010. The 2010 personnel expenses included \$714,000 in incentive compensation for VNBTrust, booked in accordance with pre-established formulas. In 2011, only \$116,000 was expensed for VNBTrust incentive compensation. As discussed above, additional VNBTrust incentive compensation was distributed as carried interest and therefore is not included in non-interest income or non-interest expense for 2010 and 2011. After taking into account for this \$598,000 decrease in VNBTrust incentive compensation, personnel expenses otherwise increased due to normal and budgeted pay increases for existing staff and for new positions to improve loan production and maintain compliance standards.

Net occupancy expenses for 2011 totaled \$2,324,000, down from the 2010 total of \$2,425,000. Equipment expense also decreased slightly to \$988,000 in 2011 from \$1,026,000 in 2010. For 2011 third party processing was \$742,000, up from the \$628,000 level in 2010. Marketing, advertising, and promotional expenses of \$620,000 in 2011 was down from \$668,000 in 2010.

Other expenses decreased to \$3,173,000 in 2011 from \$3,682,000 in 2010. Based on the new FDIC assessment rate schedules for smaller banks effective April 1, 2011, FDIC assessments for 2011 were \$353,000, down \$315,000 from the assessment total of \$668,000 in 2010. Another major component of this decrease in other expense was a \$276,000 writedown of other real estate owned (OREO) to its fair value less cost to sell that was realized in 2010. The Bank carried this OREO property as of December 31, 2009 at \$605,000; however, based on a new appraisal, the Bank recognized a \$276,000 writedown expense in 2010.

One of the ratios the Bank examines in its evaluation of non-interest expense is the efficiency ratio, which measures the cost to produce one dollar of revenue. A higher ratio, computed by dividing non-interest expense by the sum of net interest income and non-interest income, is an indicator of decreased efficiency. For 2011, the efficiency ratio was 82.0%, while an efficiency ratio of 73.8% was realized in 2010. Although non-interest expense decreased \$709,000 when comparing the two periods, the efficiency ratio was negatively impacted by the decrease in revenue.

Income Taxes

For 2011, income tax expense for the Bank was \$932,000, compared to \$2,070,000 for 2010. Please see Note 8 in the *Notes to Consolidated Financial Statements* for a discussion regarding net deferred tax and valuation allowance.

Interest Sensitivity

Prudent balance sheet management requires processes that monitor and protect the Bank against unanticipated or significant changes in the level of market interest rates. Net interest income stability should be maintained in changing rate environments by ensuring that interest rate risk is kept to an acceptable level.

The ability to reprice its interest-sensitive assets and liabilities over various time intervals is of critical importance. An asset-sensitive balance sheet structure implies that assets, such as loans and securities, will reprice faster than liabilities; consequently, net interest income should be positively affected in an increasing interest rate environment. Conversely, a liability-sensitive balance sheet structure implies that liabilities, such as deposits, will reprice faster than assets; consequently, net interest income should be positively affected in a decreasing interest rate environment.

The Bank uses a variety of traditional and on-balance sheet tools to manage its interest rate risk. Gap analysis, which monitors the “gap” between interest-sensitive assets and liabilities, is one such tool. For an Interest Sensitivity Analysis as of December 31, 2011, please see Table 10 to follow. In addition, the Bank uses simulation modeling to forecast future balance sheet and income statement behavior. By studying the effects on net interest income of rising, stable and falling interest rate scenarios, the Bank can position itself to take advantage of anticipated interest rate movements, and protect itself from unanticipated rate movements, by understanding the dynamic nature of its balance sheet components.

Asset Quality

Respect for loan quality in order to meet the customer expectations that the Bank stand as a reliable and consistent source of credit is entirely consistent with the responsibility to protect the Bank’s depositors and build shareholder value over the long term. Virginia National Bank maintains a diversified loan portfolio by extending credit for commercial, real estate, personal and other loans.

Within each category, the portfolio is further diversified. Loan officers are expected to seek and make as many sound and profitable loans as permitted within the parameters established by the Bank's asset/liability management policies. In doing so, it is recognized that risks must be taken, and that some level of losses is inevitable. Such losses must be kept within aggregate levels that bear an appropriate relationship to profits generated, the prevailing economic environment and accumulated reserve and capital levels.

The allowance for loan losses at December 31, 2011, was \$3,741,000, and represented 1.28% of outstanding loans. At December 31, 2010, the allowance was \$3,730,000, and represented 1.25% of outstanding loans. The purpose of the allowance is to provide for potential losses inherent in the loan portfolio. Since risks to the loan portfolio include general economic trends as well as conditions affecting individual borrowers, the allowance is an estimate.

The Bank is committed to determining, on an ongoing basis, the adequacy of its allowance for loan losses. The Bank applies historical loss rates to various pools of loans. Thereafter, the adequacy of the allowance is evaluated through reference to the following qualitative factors:

- National and local economic trends;
- Underlying collateral values;
- Loan delinquency status and trends;
- Loan risk classifications;
- Industry concentrations;
- Lending policies;
- Experience, ability and depth of lending staff; and
- Levels of policy exceptions.

Please refer to the earlier discussion of 'Allowances for Loan Losses' and to Note 4 in the *Notes to Consolidated Financial Statements* for additional insight into management's approach and methodology in estimating the allowance for loan losses.

At the end of 2011, the Bank had four loans with balances of \$403,000 classified as non-accrual. At the end of 2010, the Bank had seven loans with balances of \$4,548,000 classified as non-accrual. This significant decrease was primarily due to foreclosures of properties securing non-accrual loans. Since the Bank purchased the foreclosed properties, Other Real Estate Owned (OREO) increased from \$329,000 at year-end 2010 to \$4,242,000 as of December 31, 2011. In addition, the Bank had identified one loan of \$2,721,000 classified as troubled debt restructuring, which was still accruing interest, as of December 31, 2011. This loan was paid off in early 2012, and the Bank collected all principal and interest due. There were no other potential problem loans identified as of either December 31, 2011 or December 31, 2010.

Securities

The Bank's investment portfolio as of December 31, 2011, totaled \$91.9 million, a \$28.3 million increase from the December 31, 2010 portfolio total of \$63.6 million. In accordance with ASC320, "Investments-Debt and Equity Securities," the Bank has designated its unrestricted securities portfolio into (a) Held to maturity ("HTM") and (b) Available for sale ("AFS"). As of December 31, 2011, the HTM portfolio totaled \$6.0 million and consisted of U.S. Government-sponsored agency securities and tax exempt municipal securities. As of December 31, 2010, the HTM portfolio totaled \$7.5 million and consisted of U.S. Government-sponsored agency securities, a corporate bond, and tax exempt municipal securities. At December 31, 2011, the AFS portfolio

totaled \$84.2 million and consisted of U.S. Government-sponsored agency securities. At December 31, 2010, the AFS portfolio totaled \$54.5 million and consisted of U.S. Government-sponsored agency securities. The Bank's holdings of restricted securities totaled \$1.7 million at December 31, 2011 and consisted of Federal Reserve Bank and Federal Home Loan Bank stocks. The Bank's holdings of Federal Reserve Bank and Federal Home Loan Bank stocks totaled \$1.6 million at December 31, 2010.

Loan Portfolio

The Bank offers three major types of loans: mortgage loans, commercial loans and consumer loans. The predominant market area for these loans is Charlottesville, Albemarle County, Orange County, Winchester, Frederick County and all adjacent counties.

As of December 31, 2011, the Bank's loan portfolio totaled \$288.8 million, net of the allowance for loan losses. The Bank's loan portfolio as of December 31, 2010, totaled \$294.9 million, net of the allowance for loan losses. The 2.1% net variance from year to year was mainly attributed to a decrease in real estate construction loans of \$9.1 million, with the remaining changes spread among the other major loan categories.

Deposits

Depository accounts represent the Bank's primary source of funds and are comprised of demand deposits, interest-bearing checking accounts, money market deposit accounts and time deposits. Depository accounts held by the Bank as of December 31, 2011, totaled \$411.9 million, as compared to the December 31, 2010 total of \$407.7 million. These deposits have been provided predominantly by individuals, professionals and small businesses in the Charlottesville/Albemarle area, the Orange County area, and the Winchester area. At December 31, 2011, non-interest bearing demand deposits were \$121.0, representing a strong 29.4% of total deposits, as compared to 24.4% at December 31, 2010.

Included in these deposit totals were brokered deposits totaling \$42.4 million at December 31, 2011, compared to \$55.0 million at December 31, 2010. As of year-end 2011, \$30.9 million of these brokered deposits were reciprocal relationships established under the Certificate of Deposit Account Registry Service (CDARS)TM, whereby depositors can obtain FDIC insurance on deposits up to \$50 million. The remaining brokered deposits of \$11.5 million represent bankruptcy trustee deposits placed through an agreement entered during the third quarter of 2011 with Financial Software Solutions, L.L.C., which provides its TrusteSolutionsTM system to the bankruptcy trustees.

Liquidity

Liquidity represents the Bank's ability to provide funds to meet customer demand for loan and deposit withdrawals without impairing profitability. Effective management of balance sheet liquidity is necessary to fund growth in earning assets and to pay liability maturities and depository customers' withdrawal requirements. The Bank has instituted Asset/Liability Management policies, including but not limited to a computer simulation model, to support liquidity controls and to enhance its management of interest rate risk and financial condition. Continuing forward, the Bank intends to maintain sufficient liquidity at all times to meet its funding commitments.

Since its opening, the Bank's customer base has provided a reliable and steadily increasing source of funds and liquidity. In addition, maturities within the securities portfolio, repayment of loan proceeds and a significant portfolio of overnight investments are additional primary sources of liquidity. The Bank has numerous secondary sources of liquidity including access to borrowing arrangements. Available borrowing arrangements maintained by the Bank include formal federal funds lines with two other commercial banks and access to the discount window at the Federal Reserve Bank of Richmond. On December 3, 2001, the Federal Home Loan Bank of Atlanta approved the Bank's application for membership, providing yet another source of secondary liquidity.

Any excess funds are sold on a daily basis in the federal funds market. The Bank maintained an average of \$51.4 million outstanding in federal funds sold during 2011. As opportunities have arisen for prudently investing this excess cash in either loans or securities, the Bank has done so. On December 31, 2011, the Bank sold \$44.6 million in the overnight federal funds market. The Bank intends to maintain sufficient liquidity at all times to meet its funding commitments.

Capital Resources

Federal banking law sets forth certain regulatory capital requirements that apply to the Bank. Within the framework established by the law, the Bank qualifies for the classification "well-capitalized," which is the highest regulatory classification. Additional information concerning the Bank's capital resources is contained in Note 12 of the *Notes to Consolidated Financial Statements*.

Impact of Inflation and Changing Prices

The consolidated financial statements and related data presented herein have been prepared in accordance with generally accepted accounting principles. These principles dictate that financial position and operating results be measured in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation.

A financial institution's assets and liabilities primarily are monetary in nature. As a result, general levels of inflation typically have a less significant effect on financial performance than do changes in interest rates; however, non-interest expenses tend to rise in periods of general inflation.

Off-Balance Sheet Arrangements

The Bank is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist primarily of commitments to extend credit and standby letters of credit. Additional information concerning the Bank's off-balance sheet arrangements is contained in Note 10 of the *Notes to the Consolidated Financial Statements*.

Contractual Commitments

In the normal course of business, the Bank enters into contractual obligations, including obligations on lease arrangements, contractual commitments for capital expenditures, and service contracts. The significant contractual obligations include the leasing of certain of its banking and operations offices under operating lease agreements on terms ranging from 1 to 20 years with renewal options.

Following is a schedule of future minimum rental payments under non-cancelable operating leases that have initial or remaining terms in excess of one year as of December 31, 2011:

(in Thousands)	<u>1 year or less</u>	<u>1-3 years</u>	<u>3-5 years</u>	<u>After 5 years</u>	<u>Total</u>
Operating lease obligations	\$ 1,052	\$ 1,769	\$ 1,479	\$ 4,135	\$ 8,435

Statistical Information

The following statistical information is provided pursuant to the requirements of Guide 3, promulgated by the Securities Act of 1933:

TABLE 1
Average Balances, Interest Income and Expense, and Average Yields and Costs

	<u>Year Ended December 31, 2011</u>			<u>Year Ended December 31, 2010</u>			<u>Year Ended December 31, 2009</u>		
	Average Balance	Interest Income / Expense	Average Yield/Cost	Average Balance	Interest Income / Expense	Average Yield/Cost	Average Balance	Interest Income / Expense	Average Yield/Cost
	(in Thousands)			(in Thousands)			(in Thousands)		
Assets:									
Securities	\$89,227	\$2,019	2.26%	\$50,010	\$1,363	2.73%	\$30,956	\$1,033	3.34%
Loans:									
Real estate	240,429	13,573	5.65%	255,556	14,945	5.85%	242,283	14,270	5.89%
Commercial	38,128	1,717	4.50%	33,381	1,636	4.90%	38,885	1,881	4.84%
Consumer	11,909	491	4.12%	13,582	587	4.32%	13,642	562	4.12%
Total Loans	290,466	15,781	5.43%	302,519	17,168	5.68%	294,810	16,713	5.67%
Fed Funds Sold	51,444	48	0.09%	46,582	45	0.10%	35,032	55	0.16%
Other Interest Bearing Deposits	-	-	0.00%	-	-	0.00%	1,368	40	2.92%
Total Earning Assets	431,137	17,848	4.14%	399,111	18,576	4.65%	362,166	17,841	4.92%
Less: Allowance for Loan Losses	3,732			3,783			3,427		
Total Non-Earning Assets	35,532			34,566			34,683		
Total Assets	<u>\$462,937</u>			<u>\$429,894</u>			<u>\$393,422</u>		
Liabilities and Shareholders' Equity:									
Interest Checking	\$62,638	\$31	0.05%	\$63,254	\$31	0.05%	\$52,931	\$26	0.05%
Money Market Deposits	90,980	168	0.18%	85,782	165	0.19%	88,102	183	0.21%
Certificates of Deposit:									
\$100,000 and over	109,364	1,132	1.04%	100,468	1,199	1.19%	76,202	1,194	1.57%
Under \$100,000	36,966	436	1.18%	34,619	484	1.40%	40,597	839	2.07%
Total Interest-Bearing Deposits	299,948	1,767	0.59%	284,123	1,879	0.66%	257,832	2,242	0.87%
Federal Funds Purchased and Securities Sold									
Under Agreements to Repurchase	2,672	6	0.22%	2,313	5	0.22%	3,713	8	0.22%
Total Interest-Bearing Liabilities	302,620	1,773	0.59%	286,436	1,884	0.66%	261,545	2,250	0.86%
Non-Interest-Bearing Liabilities:									
Demand deposits	111,649			99,709			91,907		
Other liabilities	1,389			1,149			995		
Total Liabilities	415,658			387,294			354,447		
Shareholders' Equity	47,279			42,600			38,975		
Total Liabilities and Shareholders' Equity	<u>\$462,937</u>			<u>\$429,894</u>			<u>\$393,422</u>		
Net Interest Income		\$16,075			\$16,692			\$15,591	
Interest Rate Spread (1)			3.55%			3.99%			4.06%
Interest Expense as a Percentage of Average Earning Assets			0.41%			0.47%			0.62%
Net Interest Margin (2)			3.73%			4.18%			4.30%

(1) Interest spread is the average yield earned on earning assets less the average rate paid on interest-bearing liabilities.

(2) Net interest margin is net interest income expressed as a percentage of average earning assets.

TABLE 2
Volume and Rate Analysis

The following table describes the impact on the net interest income of the Bank resulting from changes in average balances and average rates for the periods indicated. The change in interest due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

2011 compared to 2010			
<i>(in Thousands)</i>			
Change due to:			
	Volume	Rate	Increase / Decrease
Assets:			
Securities	\$ 920	\$ (264)	\$ 656
Loans:			
Real estate	(865)	(507)	(1,372)
Commercial	221	(140)	81
Consumer	(70)	(26)	(96)
Total loans	(714)	(673)	(1,387)
Federal funds sold	4	(1)	3
Total earning assets	\$ 210	\$ (938)	\$ (728)
Liabilities and Shareholders' Equity:			
Interest-bearing deposits:			
Interest checking	\$ -	\$ -	\$ -
Money market	10	(7)	3
Certificates of deposit:			
\$100,000 and over	100	(167)	(67)
Under \$100,000	31	(79)	(48)
Total interest-bearing deposits	141	(253)	(112)
Short-term borrowings	1	-	1
Total interest-bearing liabilities	142	(253)	(111)
Change in net interest income	\$ 68	\$ (685)	\$ (617)

2010 compared to 2009			
<i>(in Thousands)</i>			
Change due to:			
	Volume	Rate	Increase / Decrease
Assets:			
Securities	\$ 546	\$ (216)	\$ 330
Loans:			
Real estate	777	(102)	675
Commercial	(270)	25	(245)
Consumer	(2)	27	25
Total loans	505	(50)	455
Other interest bearing deposits	(20)	(20)	(40)
Federal funds sold	15	(25)	(10)
Total earning assets	\$ 1,046	\$ (311)	\$ 735
Liabilities and Shareholders' Equity:			
Interest-bearing deposits:			
Interest checking	\$ 5	\$ -	\$ 5
Money market	(5)	(13)	(18)
Certificates of deposit:			
\$100,000 and over	329	(324)	5
Under \$100,000	(111)	(244)	(355)
Total interest-bearing deposits	218	(581)	(363)
Short-term borrowings	(3)	-	(3)
Total interest-bearing liabilities	215	(581)	(366)
Change in net interest income	\$ 831	\$ 270	\$ 1,101

TABLE 3
Securities Held to Maturity and Available for Sale
Maturity Distribution and Average Yields

Carrying Value of Securities

	December 31, 2011	December 31, 2010	December 31, 2009
	(in Thousands)	(in Thousands)	(in Thousands)
Securities Held to Maturity			
Amortized Cost:			
U.S. Government-Sponsored Agencies	\$4,013	\$4,027	\$ -
Corporate Bonds and Notes	-	1,510	1,518
Tax Exempt Municipal Securities	1,975	1,984	1,994
	\$5,988	\$7,521	\$3,512

Securities Available for Sale

Fair Value:			
U.S. Government-Sponsored Agencies	\$84,150	\$54,520	\$30,273
	\$84,150	\$54,520	\$30,273

Restricted Securities

Cost:			
Federal Reserve Bank Stock	\$1,030	\$836	\$820
Federal Home Loan Bank Stock	698	722	722
	\$1,728	\$1,558	\$1,542

The Bank does not hold any derivative instruments. The Bank held no issues that exceeded ten percent of Shareholders' Equity at December 31, 2011

Maturities of Securities at December 31, 2011

	Amortized Cost	Fair Value	Weighted
	(in Thousands)	(in Thousands)	Average Yield
U.S. Government-Sponsored Agencies:			
One year or less	\$14,234	\$14,525	2.95%
After one year to five years	71,324	73,687	1.98%
	\$85,558	\$88,212	2.14%
Tax Exempt Municipal Securities			
After one year to five years	\$1,975	\$2,019	1.64%
	\$1,975	\$2,019	1.64%
Total Securities ⁽¹⁾	\$87,533	\$90,231	

(1) Excludes Federal Reserve Bank and Federal Home Loan Bank stocks which have no stated maturity dates.

TABLE 4
Loan Portfolio and Maturity Schedule of Selected Loans

	<u>Dec. 31,</u> <u>2011</u>	<u>Dec. 31,</u> <u>2010</u>	<u>Dec. 31,</u> <u>2009</u>	<u>Dec. 31,</u> <u>2008</u>	<u>Dec. 31,</u> <u>2007</u>
	(in Thousands)	(in Thousands)	(in Thousands)	(in Thousands)	(in Thousands)
Commercial	\$42,157	\$40,737	\$38,955	\$41,915	\$34,351
Real estate construction	17,475	26,645	38,462	32,761	23,752
Real estate mortgage:					
Residential	78,304	73,158	87,298	74,637	51,600
Non-residential	110,302	113,695	109,919	94,686	88,171
Home equity loans	32,802	31,330	26,921	21,294	15,878
Total real estate mortgage	<u>221,408</u>	<u>218,183</u>	<u>224,138</u>	<u>190,617</u>	<u>155,649</u>
Consumer	11,492	13,066	14,014	12,781	13,585
Total loans	<u>292,532</u>	<u>298,631</u>	<u>315,569</u>	<u>278,074</u>	<u>227,337</u>
Less: Allowance for loan losses	<u>(3,741)</u>	<u>(3,730)</u>	<u>(3,732)</u>	<u>(3,084)</u>	<u>(2,646)</u>
Net loans	<u><u>\$288,791</u></u>	<u><u>\$294,901</u></u>	<u><u>\$311,837</u></u>	<u><u>\$274,990</u></u>	<u><u>\$224,691</u></u>

Maturities and Sensitivities of Loans to Changes in Interest Rates
As of December 31, 2011

	(in Thousands)							Total
	1 Year or Less		1 - 5 Years		After 5 Years			
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate		
Commercial loans	\$901	\$13,835	\$6,285	\$9,701	\$ -	\$11,435	\$42,157	
Real estate construction loans *	\$3,943	\$1,350	\$4,403	\$1,752	\$ -	\$6,027	\$17,475	

* includes land development and land loans

TABLE 5
Risk Elements

The Bank places a loan on non-accrual status when management believes, after considering economic and business conditions and collections efforts, that it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement, or when the loan is past due for 90 days or more, unless the debt is both well-secured and in the process of collection.

Non-Accrual Loans
(Dollar Amounts in Thousands)

	<u>December 31, 2011</u>	<u>December 31, 2010</u>	<u>December 31, 2009</u>
Total	\$ 403	\$ 4,548	\$ 8,134
Number of Loans	4	7	16

Loans Past Due 90 Days or More
(Dollar Amounts in Thousands)

	<u>December 31, 2011</u>	<u>December 31, 2010</u>	<u>December 31, 2009</u>
Total	\$ 388	\$ 197	\$ -
Number of Loans	2	1	0

TABLE 6
Summary of the Allowance for Loan Losses
(in Thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Balance, beginning of period	\$ 3,730	\$ 3,732	\$ 3,084	\$ 2,646	\$ 2,577
Loans charged off					
Real estate	549	233	232	39	261
Commercial	0	160	146	233	-
Consumer	11	42	34	12	268
Total	560	435	412	284	529
Recoveries					
Real estate	3	13	-	62	-
Commercial	11	86	40	-	31
Consumer	22	20	1	5	5
Total	36	119	41	67	36
Provision for loan losses	535	314	1,019	655	562
Balance, December 31	\$ <u>3,741</u>	\$ <u>3,730</u>	\$ <u>3,732</u>	\$ <u>3,084</u>	\$ <u>2,646</u>
 Net charge-offs to average loans	 0.18%	 0.10%	 0.13%	 0.09%	 0.22%
Allowance for loan losses as a percentage of period-end total loans	1.28%	1.25%	1.18%	1.11%	1.16%

TABLE 7
Allocation of the Allowance for Loan Losses

A breakdown of the allowance for loan losses is provided in the following table. The percentage of loans in each major category is also provided. See Note 4 of the *Notes to the Consolidated Financial Statements* for further detail and information on the 2011 and 2010 allocation of the Allowance for Loan Losses.

December 31, 2011

	Allowance (in Thousands)	Percentage of loans in each category to total loans
Commercial	\$397	14.41%
Real estate construction	319	5.97
Real estate mortgage	2,954	75.69
Consumer	68	3.93
Unallocated	3	N/A
Totals	\$3,741	100.00%

December 31, 2010

	Allowance (in Thousands)	Percentage of loans in each category to total loans
Commercial	\$476	13.64%
Real estate construction	488	8.92
Real estate mortgage	2,644	73.06
Consumer	122	4.38
Totals	\$3,730	100.00%

December 31, 2009

	Allowance (in Thousands)	Percentage of loans in each category to total loans
Commercial	\$545	12.34%
Real estate construction	604	12.19
Real estate mortgage	2,488	71.03
Consumer	95	4.44
Totals	\$3,732	100.00%

December 31, 2008

	Allowance (in Thousands)	Percentage of loans in each category to total loans
Commercial	\$465	15.08%
Real estate construction	363	11.77
Real estate mortgage	2,114	68.55
Consumer	142	4.60
Totals	\$3,084	100.00%

December 31, 2007

	Allowance (in Thousands)	Percentage of loans in each category to total loans
Commercial	\$400	15.12%
Real estate construction	276	10.43
Real estate mortgage	1,812	68.48
Consumer	158	5.97
Totals	\$2,646	100.00%

TABLE 8
Deposits

	<u>Average Deposits and Rates Paid</u>					
	<u>Year Ended December 31, 2011</u>		<u>Year Ended December 31, 2010</u>		<u>Year Ended December 31, 2009</u>	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(in Thousands)		(in Thousands)		(in Thousands)	
Non-Interest-Bearing Demand Deposits	\$111,649		\$99,709		\$91,907	
Interest Checking	62,638	0.05 %	63,254	0.05 %	52,931	0.05 %
Money Market Deposits	90,980	0.18	85,782	0.19	88,102	0.21
Certificates of Deposit:						
\$100,000 and over	109,364	1.04	100,468	1.19	76,202	1.57
Under \$100,000	36,966	1.18	34,619	1.40	40,597	2.07
Total Interest-Bearing Deposits	299,948	0.59 %	284,123	0.66 %	257,832	0.87 %
Total Deposits	\$411,597		\$383,832		\$349,739	

Maturities of CD's of \$100,000 and Over

	<u>December 31, 2011</u>	
	Amount	Percentage
	(in Thousands)	
Three months or less	\$61,083	65.85 %
Over three months to six months	16,690	17.99
Over six months to one year	8,241	8.89
Over one year	6,742	7.27
Totals	\$92,756	100.00 %

TABLE 9
Consolidated Return on Equity and Assets

The annualized ratio of net income to average total assets and average shareholders' equity and certain other ratios for the periods indicated are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Return on average assets	0.51%	0.94%	0.50%
Return on average equity	4.95%	9.46%	5.00%
Average equity to average assets	10.21%	9.91%	9.91%
Dividend payout ratio	0.00%	0.00%	0.00%

Short-Term Borrowings

	<u>2011</u>	<u>2010</u>	<u>2009</u>
	(dollar amounts in thousands)		
Federal funds purchases and securities sold under agreements to repurchase:			
Period-end balance	\$ 2,623	\$ 1,801	\$ 3,610
Weighted average interest rate	0.17%	0.26%	0.24%
Maximum amount at any month-end	\$ 3,984	\$ 3,801	\$ 4,981
Average balance outstanding	\$ 2,672	\$ 2,313	\$ 3,713
Weighted average interest rate	0.22%	0.22%	0.22%

TABLE 10
Interest Sensitivity Analysis
As of December 31, 2011

(in Thousands)

	<u>Within 90 days</u>	<u>90-365 days</u>	<u>1 to 4 years</u>	<u>Over 4 years</u>	<u>Total</u>
<u>Earning Assets</u>					
Loans	\$ 110,500	\$ 36,359	\$ 116,388	\$ 29,285	\$ 292,532
Investment securities	2,605	14,234	68,149	6,878	91,866
Federal funds sold	44,567	-	-	-	44,567
Total earning assets	<u>\$ 157,672</u>	<u>\$ 50,593</u>	<u>\$ 184,537</u>	<u>\$ 36,163</u>	<u>\$ 428,965</u>
<u>Interest-Bearing Liabilities</u>					
Interest checking	\$ 2,422	\$ 7,266	\$ 29,064	\$ 29,870	\$ 68,622
Money market deposits	10,898	32,693	47,224	-	90,815
Time deposits	84,099	34,342	8,647	4,354	131,442
Repurchase agreements	2,623	-	-	-	2,623
Total interest-bearing liabilities	<u>\$ 100,042</u>	<u>\$ 74,301</u>	<u>\$ 84,935</u>	<u>\$ 34,224</u>	<u>\$ 293,502</u>
Period gap	\$ 57,630	\$ (23,708)	\$ 99,602	\$ 1,939	\$ 135,463
Cumulative gap	\$ 57,630	\$ 33,922	\$ 133,524	\$ 135,463	
Ratio of cumulative gap to total earning assets	13.43%	7.91%	31.13%	31.58%	

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not required for smaller reporting company.

Item 8 - CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**VIRGINIA NATIONAL BANK AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)**

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
ASSETS		
Cash and due from banks	\$ 12,477	\$ 15,021
Federal funds sold	44,567	58,505
Securities:		
Available for sale, at fair value	84,150	54,520
Held to maturity, at amortized cost (Fair value - \$6,081 in 2011, \$7,649 in 2010)	5,988	7,521
Restricted securities, at cost	1,728	1,558
Total securities	<u>91,866</u>	<u>63,599</u>
 Total loans	 292,532	 298,631
Allowance for loan losses	(3,741)	(3,730)
Total loans, net	<u>288,791</u>	<u>294,901</u>
 Premises and equipment, net	 10,692	 11,782
Other real estate owned, net of valuation allowance	4,242	329
Bank owned life insurance	6,869	5,061
Accrued interest receivable and other assets	4,562	9,099
Total assets	<u>\$ 464,066</u>	<u>\$ 458,297</u>
 LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Demand deposits:		
Noninterest-bearing	\$ 120,989	\$ 99,617
Interest-bearing	68,622	64,323
Money market deposit accounts	90,815	90,749
Certificates of deposit and other time deposits	131,442	152,999
Total deposits	<u>411,868</u>	<u>407,688</u>
Securities sold under agreements to repurchase	2,623	1,801
Accrued interest payable and other liabilities	654	3,287
Total liabilities	<u>415,145</u>	<u>412,776</u>
 Shareholders' equity:		
Preferred stock, \$2.50 par value, 2,000,000 shares authorized, no shares outstanding	-	-
Common stock, \$2.50 par value, 5,000,000 shares authorized; 2,690,220 shares issued and outstanding in 2011 (including 863 non-vested shares); 2,339,322 shares issued and outstanding in 2010 (including 2,500 non-vested shares)	6,723	5,842
Capital surplus	27,705	22,196
Retained earnings	12,773	16,566
Accumulated other comprehensive income	1,720	917
Total shareholders' equity	<u>48,921</u>	<u>45,521</u>
Total liabilities and shareholders' equity	<u>\$ 464,066</u>	<u>\$ 458,297</u>

See Notes to Consolidated Financial Statements

VIRGINIA NATIONAL BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2011 and 2010
(in thousands, except per share data)

	2011	2010
Interest and dividend income:		
Loans, including fees	\$ 15,781	\$ 17,168
Federal funds sold	48	45
Held to maturity securities:		
Taxable	109	89
Tax exempt	33	33
Available for sale securities:		
Taxable	1,818	1,188
Dividends	59	53
Total interest and dividend income	17,848	18,576
Interest expense:		
Demand and savings deposits	199	196
Certificates and other time deposits	1,568	1,683
Federal funds purchased and securities sold under agreements to repurchase	6	5
Total interest expense	1,773	1,884
NET INTEREST INCOME	16,075	16,692
Provision for loan losses	535	314
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	15,540	16,378
Noninterest income:		
Trust income	2,588	5,611
Customer service fees	1,081	1,149
Debit/credit card and ATM fees	669	597
Earnings/increase in value of bank owned life insurance	596	211
Other	172	236
Total noninterest income	5,106	7,804
Noninterest expenses:		
Salaries and employee benefits	9,526	9,653
Net occupancy expense	2,324	2,425
Equipment expense	988	1,026
Other	4,535	4,978
Total noninterest expenses	17,373	18,082
INCOME BEFORE INCOME TAXES	3,273	6,100
Provision for income taxes	932	2,070
NET INCOME	\$ 2,341	\$ 4,030
Net Income Per Share, Basic	\$ 0.87	\$ 1.50
Net Income Per Share, Diluted	\$ 0.87	\$ 1.50

See Notes to Consolidated Financial Statements. Per share information for all periods have been restated to reflect a 1.15 to 1.00 stock dividend paid on June 30, 2011.

VIRGINIA NATIONAL BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2011 and 2010
(in thousands)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Comprehensive Income	Total
Balance, December 31, 2009	\$5,837	\$21,792	\$12,536	\$738		\$40,903
Equity adjustment for vested stock grants	5	(14)	-	-		(9)
Stock option/grant expense	-	418	-	-		418
Comprehensive income:						
Net income	-	-	4,030	-	\$4,030	4,030
Unrealized holding gains arising during the period, (net of tax, \$91)	-	-	-	179	179	179
Total comprehensive income	-	-	-	-	\$4,209	-
Balance, December 31, 2010	<u>\$5,842</u>	<u>\$22,196</u>	<u>\$16,566</u>	<u>\$917</u>		<u>\$45,521</u>
Balance, December 31, 2010	\$5,842	\$22,196	\$16,566	\$917		\$45,521
Equity adjustment for vested stock grants	5	(12)	-	-		(7)
Stock option/grant expense	-	263	-	-		263
Stock dividend: 1.15 for 1 as of June 30, 2011	876	5,258	(6,134)	-		-
Comprehensive income:						
Net income	-	-	2,341	-	\$2,341	2,341
Unrealized holding gains arising during the period, (net of tax, \$413)	-	-	-	803	803	803
Total comprehensive income	-	-	-	-	\$3,144	-
Balance, December 31, 2011	<u>\$6,723</u>	<u>\$27,705</u>	<u>\$12,773</u>	<u>\$1,720</u>		<u>\$48,921</u>

See Notes to Consolidated Financial Statements

VIRGINIA NATIONAL BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOW
For the Years Ended December 31, 2011 and 2010
(in Thousands)

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 2,341	\$ 4,030
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	535	314
Net amortization and accretion of securities	595	372
Depreciation and amortization	1,554	1,672
Deferred tax (benefit)	777	(285)
Stock option/stock grant expense	263	418
Writedown of other real estate owned	-	276
Loss on disposal of Bank property	-	47
Decrease in accrued interest receivable and other assets	1,539	384
(Decrease) increase in accrued interest payable and other liabilities	(2,633)	663
Net cash provided by operating activities	4,971	7,891
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of held to maturity securities	\$ -	\$ (4,036)
Purchases of available for sale securities	(34,000)	(26,322)
Net increase in restricted investments	(170)	(16)
Proceeds from maturities, calls and principal payments of held to maturity securities	1,524	-
Proceeds from maturities, calls and principal payments of available for sale securities	5,000	2,000
Net decrease in loans	1,333	16,047
Proceeds from sale of other real estate owned	329	575
Proceeds from sale of Bank property	-	1
Purchase of premises and equipment	(464)	(287)
Net cash used in investing activities	(26,448)	(12,038)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase (decrease) in demand deposits, NOW accounts and money market accounts	\$ 25,737	\$ (13,356)
Net increase (decrease) in certificates of deposit and other time deposits	(21,557)	26,887
Net increase (decrease) in securities sold under agreements to repurchase	822	(1,809)
Net equity adjustment for stock grants	(7)	(9)
Net cash provided by financing activities	4,995	11,713
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	\$ (16,482)	\$ 7,566
CASH AND CASH EQUIVALENTS:		
Beginning of period	\$ 73,526	\$ 65,960
End of period	\$ 57,044	\$ 73,526
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash payments for:		
Interest	\$ 1,825	\$ 1,872
Taxes	\$ 1,610	\$ 2,125
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Unrealized gain on available for sale securities	\$ 1,216	\$ 270
Transfer of loans to foreclosed assets	\$ 4,242	\$ 575

See Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies:

The accounting and reporting policies of Virginia National Bank conform to accounting principles generally accepted in the United States of America and to the reporting guidelines prescribed by regulatory authorities. The following is a description of the more significant of those policies and practices.

Organization – Virginia National Bank (“Bank”) was organized in 1998 under federal law as a national banking association to engage in a general banking business serving the community in and around Charlottesville and Albemarle County, Virginia.

On May 1, 2007, the Office of the Comptroller of the Currency (“OCC”) granted conditional approval to the Bank’s application to establish a new national trust bank with the title VNBTrust, National Association (“VNBTrust”), which is now operating as a wholly-owned subsidiary of the Bank. Additionally, the OCC approved the Bank’s application for VNBTrust to create a wholly-owned operating subsidiary, VNB Investment Management Company, LLC, a Delaware limited liability corporation, which has approval to organize and manage two private investment funds. One fund, known as Swift Run Capital, is in operation. In January 2010, VNB Investment Management Company, LLC changed its name to Swift Run Capital Management, LLC.

Principles of Consolidation – The consolidated financial statements include the accounts of Virginia National Bank (Bank) and its wholly-owned subsidiary, VNBTrust, N.A. All significant intercompany balances and transactions have been eliminated in consolidation.

Securities – Unrestricted investments are to be classified in three categories as described below.

- **Securities Held to Maturity** – Securities classified as held to maturity are those debt and equity securities the Bank has both the positive intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions.
- **Securities Available for Sale** – Securities classified as available for sale are those debt and equity securities that the Bank intends to hold for an indefinite period of time but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Bank’s assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available for sale are carried at fair value. Unrealized gains or losses are reported as a separate component of other comprehensive income. Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings.
- **Trading Securities** – Trading securities, which are generally held for the short term in anticipation of market gains, are carried at fair value. Realized and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

unrealized gains and losses on trading account assets are included in interest income on trading account securities. The Bank had no securities classified as trading securities at either December 31, 2011 or December 31, 2010.

- **Restricted Securities** – As members of the Federal Reserve Bank and the Federal Home Loan Bank (“FHLB”) of Atlanta, the Bank is required to maintain certain minimum investments in the common stock of the Federal Reserve Bank and the FHLB, which are carried at cost. Required levels of investments are based upon the Bank’s capital and a percentage of qualifying assets.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (1) the Bank intends to sell the security or (2) it is more likely than not that the Bank will be required to sell the security before recovery of its amortized cost basis. If, however, the Bank does not intend to sell the security and it is not more-than-likely that the Bank will be required to sell the security before recovery, the Bank must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income.

Loans – Virginia National Bank makes commercial, financial, residential and consumer loans to customers predominantly in its market areas of Central Virginia and Winchester. The loan portfolio is well diversified and generally is collateralized by assets of the customers. The loans are expected to be repaid from cash flow or proceeds from the sale of selected assets of the borrowers.

Loans are shown on the balance sheet net of the allowance for loan losses. Interest is computed by methods which result in level rates of return on principal. Loans of all classes are charged off when in the opinion of management they are deemed to be uncollectible, after taking into consideration such factors as the current financial condition of the customer and the underlying collateral and guarantees.

Accounting guidance requires that the impairment of loans that have been separately identified for evaluation is to be measured based on the present value of expected future cash flows or, alternatively, the observable market price of the loans or the fair value of the collateral. However, for those loans that are collateral dependent (that is, if repayment of those loans is expected to be provided solely by the underlying collateral) and for which management has determined foreclosure is probable, the measure of impairment of those loans is to be based on the fair value of the collateral. Additionally, accounting guidance

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

requires certain disclosures about investments in impaired loans and the allowance for loan losses and interest income recognized on loans.

A loan is considered impaired when it is probable that the Bank will be unable to collect all principal and interest amounts according to the contractual terms of the loan agreement. Factors involved in determining impairment include, but are not limited to, expected future cash flows, financial condition of the borrower, and current economic conditions. A performing loan may be considered impaired, if the factors above indicate a need for impairment. A loan on non-accrual status may not be impaired if it is in the process of collection or there is an insignificant shortfall in payment. An insignificant delay of less than 30 days or a shortfall of less than 5% of the required principal and interest payment generally does not indicate an impairment situation, if in management's judgment the loan will be paid in full. Charge-offs for impaired loans occur when the loan, or a portion of the loan, is determined to be uncollectible, as is the case for all loans.

Loans are placed on non-accrual when a loan is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more. Any unpaid interest previously accrued on those loans is reversed from income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are applied as a reduction of the loan principal balance. Interest income on other non-accrual loans is recognized only to the extent of interest payments received.

The past due status of a loan is based on the contractual due date of the most delinquent payment due. Loans, including impaired loans, are generally classified as non-accrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well-secured and in the process of collection. Loans greater than 90 days past due may remain on an accrual status if management determines it has adequate collateral to cover the principal and interest.

If a loan or a portion of a loan is adversely classified, or is partially charged off, the loan is generally classified as non-accrual. Additionally, whenever management becomes aware of facts or circumstances that may adversely impact the collectability of principal or interest on loans, it is management's practice to place such loans on a non-accrual status immediately, rather than delaying such action until the loans become 90 days past due.

Additionally, troubled debt restructurings are considered impaired loans. Troubled debt restructurings occur when the Bank agrees to modify the original terms of a loan by granting a concession that it would not otherwise consider due to the deterioration in the financial condition of the borrower. These concessions are done in an attempt to improve the paying capacity of the borrower and in some cases avoid foreclosure and are made with the intent to restore the loan to a performing status once sufficient payment history can be demonstrated. These concessions could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Allowance for Loan Losses – The allowance for loan losses is maintained at a level which, in management’s judgment, is adequate to absorb credit losses inherent in the loan portfolio. The allowance for loan losses is evaluated on a regular basis by management and is based upon management’s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

To determine the total allowance for loan losses, the Bank estimates the reserves needed for each segment of the portfolio, including loans analyzed individually and loans analyzed on a pooled basis. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows.

To determine the balance of the allowance account, loans are pooled by the following portfolio segments and an amount is assigned for each of these segments: (1) commercial loan portfolio, (2) real estate construction and land loan portfolio, (3) real estate mortgage loan portfolio, and (4) consumer loan portfolio. Each of these segments is further broken down by classes in order to estimate the required reserves, based on the associated risks within each class, as well as historical loss data gathered regarding each class. These historical loss percentages, calculated using an average eight quarter rolling basis, are applied to each pool. In addition, eight qualitative factors are applied to each segment and class. For each class of loans, management must exercise significant judgment to determine the estimation method that fits the credit risk characteristics of its various segments. Basis points are assigned to the various classifications in order to provide a method for quantifying the amount required for each pool of loans. Although the assignment of basis points is highly subjective, qualified management utilizes its significant knowledge and experience related to both the market and history of the Bank’s loan losses.

During these evaluations, particular characteristics associated with a segment of the loan portfolio are also considered. These characteristics are detailed below:

- Commercial loans not secured by real estate carry risks associated with the successful operation of a business, and the repayments of these loans depend on the profitability and cash flows of the business. Additional risk relates to the value of collateral where depreciation occurs and the valuation is less precise.
- Loans secured by commercial real estate also carry risks associated with the success of the business and the ability to generate a positive cash flow sufficient to service debts. Real estate security diminishes risks only to the extent that a market exists for the subject collateral.
- Consumer loans carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral, such as automobiles which may depreciate more rapidly than other assets. In addition, these loans may be unsecured. Consumer

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

loans are more likely than real estate loans to be immediately affected in an adverse manner by job loss, divorce, illness or personal bankruptcy. Consumer loans are further segmented into consumer revolving lines and all other consumer loans.

- Real estate secured construction loans carry risks that a project will not be completed as scheduled and budgeted and that the value of the collateral may, at any point, be less than the principal amount of the loan. Additional risks may occur if the general contractor, who may not be a loan customer, is unable to finish the project as planned due to financial pressures unrelated to the project.
- Residential real estate loans carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the non-collectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Because of uncertainties inherent in the estimation process, management's estimate of credit losses inherent in the loan portfolio and the related allowance may change in the near term.

Transfers of Financial Assets – Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank – put presumptively beyond reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Foreclosed Assets – Assets acquired through, or in lieu of, loan foreclosures are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management, and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses for foreclosed assets.

Premises and Equipment – Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed by the straight-line method based on the estimated useful lives of assets, which range from 3 to 40 years. Expenditures for repairs and maintenance are charged to expense as incurred. The costs of major renewals and betterments are capitalized and depreciated over their estimated useful lives. Upon disposition, the asset and related accumulated depreciation are removed from the books and any resulting gain or loss is charged to income.

Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, deferred tax assets, and fair value measurements.

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

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

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

Comprehensive Income – Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

Advertising Costs – The Bank follows the policy of charging the costs of advertising to expense as they are incurred.

Cash and Cash Equivalents – For purposes of the statements of cash flows, the Bank considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash and cash equivalents consist of cash on hand, funds due from banks, and federal funds sold.

VNBTrust, N.A. – Securities and other property held by VNBTrust in a fiduciary or agency capacity are not assets of the Bank and are not included in the accompanying consolidated financial statements.

Stock-Based Compensation – The Bank accounts for all plans under recognition and measurement accounting principles which require that the compensation cost relating to share-based payment transactions be recognized in the financial statements. Share-based compensation arrangements include share options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. Stock-based compensation is estimated at the date of grant, using the Black-Scholes option valuation model for determining fair value. The model employs the following assumptions:

- Dividend yield - calculated as the ratio of historical cash dividends paid per share of common stock to the stock price on the date of grant;
- Expected life (term of the option) - based on the average of the contractual life and vesting schedule for the respective option;
- Expected volatility - based on the monthly historical volatility of the Bank's stock price over the expected life of the options;
- Risk-free interest rate - based upon the U.S. Treasury bill yield curve, for periods within the contractual life of the option, in effect at the time of grant.

The Bank is required to estimate forfeitures when recognizing compensation expense and that this estimate of forfeitures be adjusted over the requisite service period or vesting schedule based on the extent to which actual forfeitures differ from such estimates. Changes in estimated forfeitures are recognized through a cumulative catch-up adjustment, which is recognized in the period of change, and also will impact the amount of estimated unamortized compensation expense to be recognized in future periods.

Reclassifications – Certain reclassifications have been made to prior periods to conform to current year presentation.

Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, "Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements." ASU 2010-06 amends

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of the new guidance did not have a material impact on the Bank's consolidated financial statements.

In July 2010, the FASB issued ASU 2010-20, "Receivables (Topic 310) – Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses." The new disclosure guidance significantly expands the existing requirements and will lead to greater transparency into an entity's exposure to credit losses from lending arrangements. The extensive new disclosures of information as of the end of a reporting period became effective for both interim and annual reporting periods ending on or after December 15, 2010. Specific disclosures regarding activity that occurred before the issuance of the ASU, such as the allowance roll forward and modification disclosures, will be required for periods beginning on or after December 15, 2010. The Bank has included the required disclosures in its consolidated financial statements.

In March 2011, the SEC issued Staff Accounting Bulletin (SAB) 114. This SAB revises or rescinds portions of the interpretive guidance included in the codification of the Staff Accounting Bulletin Series. This update is intended to make the relevant interpretive guidance consistent with current authoritative accounting guidance issued as a part of the FASB's Codification. The principal changes involve revision or removal of accounting guidance references and other conforming changes to ensure consistency of referencing through the SAB Series. The effective date for SAB 114 is March 28, 2011. The adoption of the new guidance did not have a material impact on the Bank's consolidated financial statements.

In January 2011, the FASB issued ASU 2011-01, "Receivables (Topic 310) – Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings." The amendments in this ASU temporarily delayed the effective date of the disclosures about troubled debt restructurings in Update 2010-20 for public entities. The delay was intended to allow the Board time to complete its deliberations on what constitutes a troubled debt restructuring. The effective date of the new disclosures about troubled debt restructurings for public entities and the guidance for determining what constitutes a troubled debt restructuring was effective for interim and annual periods ending after June 15, 2011. The Bank has adopted ASU 2011-01 and included the required disclosures in its consolidated financial statements.

In April 2011, the FASB issued ASU 2011-02, "Receivables (Topic 310) – A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring." The amendments in this ASU clarify the guidance on a creditor's evaluation of whether it has granted a concession to a debtor. They also clarify the guidance on a creditor's evaluation of whether a debtor is experiencing financial difficulty. The amendments in this ASU are

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effective for the first interim or annual period beginning on or after June 15, 2011. Early adoption is permitted. Retrospective application to the beginning of the annual period of adoption for modifications occurring on or after the beginning of the annual adoption period is required. As a result of applying these amendments, an entity may identify receivables that are newly considered to be impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. The Bank has adopted ASU 2011-02 and included the required disclosures in its consolidated financial statements.

In April 2011, the FASB issued ASU 2011-03, “Transfers and Servicing (Topic 860) – Reconsideration of Effective Control for Repurchase Agreements.” The amendments in this ASU remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee and (2) the collateral maintenance implementation guidance related to that criterion. The amendments in this ASU are effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted. The Bank is currently assessing the impact that ASU 2011-03 will have on its consolidated financial statements.

In May 2011, the FASB issued ASU 2011-04, “Fair Value Measurement (Topic 820) – Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.” This ASU is the result of joint efforts by the FASB and International Accounting Standards Board (IASB) to develop a single, converged fair value framework on how (not when) to measure fair value and what disclosures to provide about fair value measurements. The ASU is largely consistent with existing fair value measurement principles in U.S. GAAP (Topic 820), with many of the amendments made to eliminate unnecessary wording differences between U.S. GAAP and International Financial Reporting Standards (IFRS). The amendments are effective for interim and annual periods beginning after December 15, 2011 with prospective application. Early application is not permitted. The Bank is currently assessing the impact that ASU 2011-04 will have on its consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, “Comprehensive Income (Topic 220) – Presentation of Comprehensive Income.” The objective of this ASU is to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders’ equity. The amendments require that all non-owner changes in stockholders’ equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The single statement of comprehensive income should include the components of net income, a total for net income, the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. In the two-statement

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approach, the first statement should present total net income and its components followed consecutively by a second statement that should present all the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. The amendments do not change the items that must be reported in other comprehensive income, the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects, or the calculation or reporting of earnings per share. The amendments in this ASU should be applied retrospectively. The amendments are effective for fiscal years and interim periods within those years beginning after December 15, 2011. Early adoption is permitted because compliance with the amendments is already permitted. The amendments do not require transition disclosures. The Bank is currently assessing the impact that ASU 2011-05 will have on its consolidated financial statements.

In August 2011, the SEC issued Final Rule No. 33-9250, “Technical Amendments to Commission Rules and Forms related to the FASB’s Accounting Standards Codification.” The SEC has adopted technical amendments to various rules and forms under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Company Act of 1940. These revisions were necessary to conform those rules and forms to the FASB Accounting Standards Codification. The technical amendments include revision of certain rules in Regulation S-X, certain items in Regulation S-K, and various rules and forms prescribed under the Securities Act, Exchange Act and Investment Company Act. The Release was effective as of August 12, 2011. The adoption of the new guidance did not have a material impact on the Bank’s consolidated financial statements.

In December 2011, the FASB issued ASU 2011-11, “Balance Sheet (Topic 210) – Disclosures about Offsetting Assets and Liabilities.” This ASU requires entities to disclose both gross information and net information about both instruments and transactions eligible for offset in the balance sheet and instruments and transactions subject to an agreement similar to a master netting arrangement. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The Bank is currently assessing the impact that ASU 2011-11 will have on its consolidated financial statements.

In December 2011, the FASB issued ASU 2011-12, “Comprehensive Income (Topic 220) – Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05.” The amendments are being made to allow the Board time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the Board is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, entities should continue to report

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reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. All other requirements in ASU 2011-05 are not affected by ASU 2011-12, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Bank is currently assessing the impact that ASU 2011-12 will have on its consolidated financial statements.

2. Securities

The amortized cost and fair values of securities held to maturity as of December 31, 2011 are as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(in Thousands)			
U.S. Government agencies	\$ 4,013	\$ 49	\$ -	\$ 4,062
Tax exempt municipals	1,975	44	-	2,019
	<u>\$ 5,988</u>	<u>\$ 93</u>	<u>\$ -</u>	<u>\$ 6,081</u>

The amortized cost and fair values of securities held to maturity as of December 31, 2010 are as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(in Thousands)			
U.S. Government agencies	\$ 4,027	\$ 58	\$ -	\$ 4,085
Corporate securities	1,510	38	-	1,548
Tax exempt municipals	1,984	32	-	2,016
	<u>\$ 7,521</u>	<u>\$ 128</u>	<u>\$ -</u>	<u>\$ 7,649</u>

The amortized cost and fair values of securities available for sale as of December 31, 2011 are as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(in Thousands)			
U.S. Government agencies	\$ 81,545	\$ 2,605	\$ -	\$ 84,150

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The amortized cost and fair values of securities available for sale as of December 31, 2010 are as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(in Thousands)			
U.S. Government agencies	\$ 53,131	\$ 1,460	\$ (71)	\$ 54,520

There were no sales of held to maturity or available for sale securities in 2011 or 2010.

In addition, the Bank held restricted securities of \$1,728,000 as of December 31, 2011 and \$1,558,000 as of December 31, 2010. These restricted securities are carried at cost and are comprised of Federal Reserve Bank stock and Federal Home Loan Bank of Atlanta stock.

The Bank's securities portfolio is made up of fixed rate bonds, whose prices move inversely with interest rates. At the end of any accounting period, the portfolio may have both unrealized gains and losses. Unrealized losses within the Bank's portfolio typically occur as market interest rates rise. Such unrealized losses are considered temporary in nature. In the event that a security would suffer an impairment for a reason that was "other-than-temporary," the Bank would be expected to write down the security's value to its new fair value, and the amount of the writedown would be included in earnings as a realized loss.

At December 31, 2011, none of the securities in the portfolio had an unrealized loss. At December 31, 2010, two of the securities in the portfolio had an unrealized loss. The following table recaps all unrealized losses in the Bank's securities portfolio at December 31, 2010:

<i>(in Thousands)</i>	<u>Continuous Unrealized Loss Position of Less Than 12 Months</u>		<u>Continuous Unrealized Loss Position of 12 Months or More</u>		<u>Total</u>	
	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
	U.S. Government Agencies	<u>\$ 7,779</u>	<u>\$ 71</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,779</u>

Securities having carrying values of \$7,735,000 at December 31, 2011 were pledged to secure deposits and for other purposes required by law. At December 31, 2010, securities having carrying values of \$8,340,000 were similarly pledged.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The amortized cost and fair value of investment securities as of December 31, 2011, by contractual maturities, are shown below:

	Amortized Cost (in Thousands)		Fair Value (in Thousands)
U.S. Government-Sponsored Agencies			
One year or less	\$ 14,234	\$	14,525
After one year to five years	71,324		73,687
	\$ 85,558	\$	88,212
Tax Exempt Municipal Securities			
After one year to five years	\$ 1,975	\$	2,019
	\$ 87,533	\$	90,231
Total Securities ⁽¹⁾	\$ 87,533	\$	90,231

(1) Excludes Federal Reserve Bank and Federal Home Loan Bank stocks which have no stated maturity dates.

3. Loans

The composition of the loan portfolio by loan classification at December 31, 2011 and 2010 appears below.

	December 31	
	2011	2010
	(in Thousands)	
Commercial	\$ 42,157	\$ 40,737
Real estate construction and land		
Residential construction	91	3,395
Other construction and land	17,384	23,250
Total construction and land	17,475	26,645
Real estate mortgage:		
1-4 family	59,995	58,107
Home equity loans	32,802	31,330
Multifamily mortgages	18,309	15,051
Commercial owner occupied	60,248	57,294
Commercial nonowner occupied	50,054	56,401
Total real estate mortgage	221,408	218,183
Consumer		
Consumer revolving credit	1,430	1,281
Consumer all other credit	10,062	11,785
Total consumer loans	11,492	13,066
Total loans	292,532	298,631
Less: Allowance for loan losses	(3,741)	(3,730)
Net loans	\$ 288,791	\$ 294,901

Included in loan balances are overdrafts, which are deposit accounts with a negative balance. As of December 31, 2011, the Bank had \$54,000 in overdrafts and \$687,000 as of December 31, 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Accounting guidance requires certain disclosures about investments in impaired loans and the allowance for loan losses and interest income recognized on loans. A loan is considered impaired when it is probable that the Bank will be unable to collect all principal and interest amounts according to the contractual terms of the loan agreement. Factors involved in determining impairment include, but are not limited to, expected future cash flows, financial condition of the borrower, and current economic conditions. Generally, loans for all classes are placed on non-accrual when a loan is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more.

At December 31, 2011, the Bank had four loans in the amount of \$403,000 classified as non-accrual, in addition to one loan of \$2,721,000 classified as troubled debt restructuring which was still accruing interest, for a total of \$3,124,000 in impaired loans. The Bank had seven loans in the amount of \$4,548,000 classified as non-accrual and impaired loans at December 31, 2010. At both December 31, 2011 and December 31, 2010, there was no valuation allowance on any of these loans after consideration was given for each borrowing as to the fair value of the collateral on the loan or the present value of expected future cash flows from the customer.

Following is a further breakdown by class of the loans classified as impaired loans as of December 31, 2011 and December 31, 2010. These loans are reported at their recorded investment, which is the carrying amount of the loan as reflected on the Bank's balance sheet, net of charge-offs and other amounts applied to reduce the net book balance. Average investment in impaired loans is computed using month-end balances for these loans.

Impaired Loans as of December 31, 2011

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
			(in Thousands)		
Impaired loans without a valuation allowance:					
Other real estate construction and land	338	447	-	475	23
Commercial owner occupied real estate	2,721	2,721	-	2,757	147
1-4 family residential mortgages	65	71	-	1,755	26
Impaired loans with a valuation allowance	-	-	-	-	-
Total impaired loans	\$ 3,124	\$ 3,239	\$ -	\$ 4,987	\$ 196

Impaired Loans as of December 31, 2010

	Recorded Investment	Unpaid Principal Balance	Associated Allowance	Average Recorded Investment	Interest Income Recognized
			(in Thousands)		
Impaired loans without a valuation allowance:					
Commercial	\$ -	\$ -	\$ -	\$ 241	\$ 25
Other real estate construction and land	547	628	-	4,913	215
Commercial owner occupied real estate	-	-	-	162	61
1-4 family residential mortgages	4,001	4,062	-	753	-
Impaired loans with a valuation allowance	-	-	-	-	-
Total impaired loans	\$ 4,548	\$ 4,690	\$ -	\$ 6,069	\$ 301

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The impaired loans classified as non-accruals are shown below by class:

Non-accrual balance	December 31, 2011	December 31, 2010
	(in Thousands)	
Other real estate construction and land	\$ 338	\$ 547
1-4 family residential mortgages	65	4,001
Total nonaccrual loans	<u>\$ 403</u>	<u>\$ 4,548</u>

There have been no loan modifications during the year ended December 31, 2011 for loans identified as troubled debt restructuring (TDR) loans, and no TDR loans that have subsequently defaulted during the year.

4. Allowance for Loan Losses

A summary of the transactions in the allowance for loan losses for the years ended December 31, 2011 and 2010 appears below:

	<u>2011</u>	<u>2010</u>
	(in Thousands)	
Balance, beginning of period	\$ 3,730	\$ 3,732
Loans charged off	(560)	(435)
Recoveries	36	119
Provision for loan losses	535	314
Balance, December 31	<u>\$ 3,741</u>	<u>\$ 3,730</u>

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Bank has segmented certain loans in the portfolio by product type. Within these segments, the Bank has sub-segmented its portfolio by classes within the segments, based on the associated risks within these classes.

LOAN SEGMENTS

Commercial

Real estate construction and land

Real estate mortgages

Consumer

LOAN CLASSES

Commercial and industrial loans

Residential construction loans

Other construction and land loans

1-4 family mortgages

Home equity lines of credit

Multifamily mortgages

Commercial owner occupied real estate

Commercial nonowner occupied real estate

Consumer revolving credit

Consumer all other credit

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Based on the internal risk ratings assigned to each credit, an historical factor is assigned to the balances for each class of loans, using an average eight quarter rolling basis. The Bank's internal creditworthiness grading system is based on experiences with similarly graded loans. Category ratings are reviewed quarterly by experienced senior lenders based on each borrower's situation. Additionally, internal and external monitoring and review of credits are conducted on an annual basis.

Loans that trend upward toward more positive risk ratings generally have a lower risk factor associated. Conversely, loans that migrate toward more negative ratings generally will result in a higher risk factor being applied to those related loan balances.

RISK RATINGS DESCRIPTION/HISTORICAL LOSS FACTOR APPLIED

Excellent 0% applied, as these loans are secured by cash and represent a minimal risk. The Bank has never experienced a loss for this category.

Good 0% applied, as these loans are secured by marketable securities within margin and represent a low risk. The Bank has never experienced a loss for this category.

Pass Loans with the following risk ratings are pooled by class and considered together as "pass."

- Satisfactory - modest risk loans where the borrower has strong and liquid financial statement and more than adequate cash flow
- Average – average risk loans where the borrower has reasonable debt service capacity
- Marginal – acceptable risk loans where the borrower has an acceptable financial statement but is leveraged
- Watch – acceptable risk loans which require more attention than normal servicing.

Historical loss factor for loans rated "pass" is applied to current balances of like-rated loans, pooled by class.

Special Mention These potential problem loans are currently protected but are potentially weak. Historical loss factor for loans rated "special mention" is applied to current balances of like-rated loans pooled by class.

Substandard These problem loans are inadequately protected by the sound worth and paying capacity of the borrower and/or the value of any collateral pledged. These loans may be considered impaired and evaluated on an individual basis. Otherwise, an historical loss factor for loans rated "substandard" is applied to current balances of all other "substandard" loans pooled by class.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Doubtful Loans with this rating have significant deterioration in the sound worth and paying capacity of the borrower and/or the value of any collateral pledged, making collection or liquidation of the loan in full highly questionable. These loans would be considered impaired and evaluated on an individual basis.

The following represents the loan portfolio designated by the internal risk ratings assigned to each credit as of December 31, 2011:

Internal Risk Rating Grades	Excellent	Good	Pass	Special Mention	Sub- standard	Doubtful	TOTAL
	(in Thousands)						
Commercial loans	\$ 707	\$ 15,432	\$ 24,505	\$ 5	\$ 1,508	\$ -	\$ 42,157
Real estate construction							
Residential construction	-	-	91	-	-	-	91
Other construction and land	-	-	12,436	3,587	1,361	-	17,384
Real estate mortgages							
1-4 family mortgages	-	1,978	55,510	1,213	1,294	-	59,995
Home equity lines of credit	-	-	32,658	35	109	-	32,802
Multifamily mortgages	-	-	17,927	-	382	-	18,309
Commercial owner occupied	-	-	53,694	230	6,324	-	60,248
Commercial nonowner occupied	-	-	42,899	2,132	5,023	-	50,054
Consumer loans							
Consumer revolving credit	-	847	583	-	-	-	1,430
Consumer all other credit	208	5,540	4,264	-	50	-	10,062
Total Loans	\$ 915	\$ 23,797	\$ 244,567	\$ 7,202	\$ 16,051	\$ -	\$ 292,532

The following represents the loan portfolio designated by the internal risk ratings assigned to each credit as of December 31, 2010:

Internal Risk Rating Grades	Excellent	Good	Pass	Special Mention	Sub- standard	Doubtful	TOTAL
	(in Thousands)						
Commercial loans	\$ 6,488	\$ 12,125	\$ 19,267	\$ 2	\$ 2,855	\$ -	\$ 40,737
Real estate construction							
Residential construction	-	-	3,395	-	-	-	3,395
Other construction and land	-	-	18,149	2,584	2,517	-	23,250
Real estate mortgages							
1-4 family mortgages	-	2,501	48,375	1,668	5,563	-	58,107
Home equity lines of credit	-	-	30,953	-	377	-	31,330
Multifamily mortgages	-	-	14,660	-	391	-	15,051
Commercial owner occupied	-	-	47,207	237	9,850	-	57,294
Commercial nonowner occupied	-	-	53,379	1,372	1,650	-	56,401
Consumer loans							
Consumer revolving credit	64	-	1,212	-	5	-	1,281
Consumer all other credit	346	4,492	6,883	-	64	-	11,785
Total Loans	\$ 6,898	\$ 19,118	\$ 243,480	\$ 5,863	\$ 23,272	\$ -	\$ 298,631

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In addition to the historical factors, the adequacy of the Bank's allowance for credit losses is evaluated through reference to eight qualitative factors, listed below and ranked in order of importance:

- 1) Changes in national and local economic conditions, including the condition of various market segments
- 2) Changes in the value of underlying collateral
- 3) Changes in volume of classified assets, measured as a percentage of capital
- 4) Changes in volume of delinquent loans
- 5) The existence and effect of any concentrations of credit and changes in the level of such concentrations
- 6) Changes in lending policies and procedures, including underwriting standards
- 7) Changes in the experience, ability and depth of lending management and staff
- 8) Changes in the level of policy exceptions

It has been the Bank's experience that the first four factors drive losses to a much greater extent than the last four factors; therefore, the first four factors are weighted more heavily. Although the markets served by the Bank remain stronger than the national economy as a whole, management continues to pay close attention on a case-by-case basis for any yet unforeseen potential ripple effects of the housing downturn and the related financial market fallout. This uncertainty has led to downgrades in the first four factors for several of the segments and classes over the past two years.

Like the historical factors, qualitative factors are not assessed against loans rated "excellent" or rated "good," since these are fully collateralized by cash or readily marketable securities.

Impaired loans are individually evaluated and, if deemed appropriate, a specific allocation is made for these loans. In reviewing the five loans in the amount of \$3,124,000 classified as impaired loans at December 31, 2011, there was no valuation allowance on any of these loans after consideration was given for each borrowing as to the fair value of the collateral on the loan or the present value of expected future cash flows from the customer.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Allowance for Credit Losses Rollforward by Portfolio Segment As of December 31, 2011

	Commercial	Real Estate Construction	Real Estate Mortgage	Consumer	Unallocated	Total
<i>(In Thousands)</i>						
Allowance for credit losses:						
Balance as of January 1, 2011	\$ 476	\$ 488	\$ 2,644	\$ 122	\$ -	\$ 3,730
Charge-offs	-	(31)	(518)	(11)	-	(560)
Recoveries	11	-	3	22	-	36
Provision for Loan Losses	(90)	(138)	825	(65)	3	535
Ending Balance	\$ 397	\$ 319	\$ 2,954	\$ 68	\$ 3	\$ 3,741

Ending Balance:

Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	397	319	2,954	68	3	3,741

Financing Receivables:

<i>(In Thousands)</i>						
Ending Balance	\$ 42,157	\$ 17,475	\$ 221,408	\$ 11,492	\$ -	\$ 292,532

Ending Balance:

Individually evaluated for impairment	-	338	2,786	-	-	3,124
Collectively evaluated for impairment	42,157	17,137	218,622	11,492	-	289,408

Allowance for Credit Losses Rollforward by Portfolio Segment For the Year Ended December 31, 2010

<i>(In Thousands)</i>	Commercial	Real Estate Construction	Real Estate Mortgage	Consumer	Unallocated	Total
2010						
Allowance for credit losses:						
Ending Balance	\$ 476	\$ 488	\$ 2,644	\$ 122	\$ -	\$ 3,730
Ending Balance:						
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	476	488	2,644	122	-	3,730
Financing Receivables:						
Ending Balance	\$ 40,737	\$ 26,645	\$ 218,183	\$ 13,066	\$ -	\$ 298,631
Ending Balance:						
Individually evaluated for impairment	-	547	4,001	-	-	4,548
Collectively evaluated for impairment	40,737	26,098	214,182	13,066	-	294,083

As previously mentioned, one of the major factors that the Bank uses in evaluating the adequacy of its allowance for loan losses is changes in the volume of delinquent loans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Management monitors payment activity on a regular basis. For all classes of loans, the Bank considers the entire balance of the loan to be contractually delinquent if the minimum payment is not received by the due date. Interest and fees continue to accrue on past due loans until they are changed to non-accrual status.

As of December 31, 2011 and December 31, 2010, the Bank showed the following aging of past due loans. Also included are loans that are 90 or more days past due but still accruing, because they are well secured and in the process of collection. As of December 31, 2011, the Bank had two loans for a balance of \$388,000 that were 90 days or more past due but still accruing. As of December 31, 2010, the Bank had only one such credit for a balance of \$197,000.

**Past Due Aging as of
December 31, 2011**

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days Past Due and Still Accruing
(in Thousands)							
Commercial loans	\$ -	\$ -	\$ -	\$ -	\$ 42,157	\$ 42,157	\$ -
Real estate construction							
Residential construction	-	-	-	-	91	91	-
Other construction and land	-	-	388	388	16,996	17,384	388
Real estate mortgages							
1-4 family mortgages	286	-	-	286	59,709	59,995	-
Home equity lines of credit	-	35	-	35	32,767	32,802	-
Multifamily mortgages	-	-	-	-	18,309	18,309	-
Commercial owner occupied	-	-	-	-	60,248	60,248	-
Commercial nonowner occupied	-	-	-	-	50,054	50,054	-
Consumer loans							
Consumer revolving credit	-	-	-	-	1,430	1,430	-
Consumer all other credit	92	-	-	92	9,970	10,062	-
Total Loans	\$ 378	\$ 35	\$ 388	\$ 801	\$ 291,731	\$ 292,532	\$ 388

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Past Due Aging as of December 31, 2010

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days Past Due and Still Accruing
	(in Thousands)						
Commercial loans	\$ 3	\$ 30	\$ -	\$ 33	\$ 40,704	\$ 40,737	\$ -
Real estate construction							
Residential construction	184	-	-	184	3,211	3,395	-
Other construction and land	40	-	246	286	22,964	23,250	-
Real estate mortgages							
1-4 family mortgages	51	-	3,126	3,177	54,930	58,107	197
Home equity lines of credit	35	13	-	48	31,282	31,330	-
Multifamily mortgages	-	-	-	-	15,051	15,051	-
Commercial owner occupied	-	-	-	-	57,294	57,294	-
Commercial nonowner occupied	-	-	-	-	56,401	56,401	-
Consumer loans							
Consumer revolving credit	-	-	-	-	1,281	1,281	-
Consumer all other credit	67	-	-	67	11,718	11,785	-
Total Loans	\$ 380	\$ 43	\$ 3,372	\$ 3,795	\$ 294,836	\$ 298,631	\$ 197

5. Other Real Estate Owned (OREO)

At December 31, 2011, OREO was \$4.2 million and was comprised of residential properties and residential lots located in Virginia. At December 31, 2010, the OREO was carried at \$329,000. Changes in the balance for OREO are as follows:

	December 31, 2011	December 31, 2010
	(in Thousands)	
Balance at beginning of year, gross	\$ 605	\$ 605
Transfer from loans	4,242	575
Previously recognized impairment losses on disposition	(276)	-
Sales proceeds	(329)	(575)
Balance at end of year, gross	\$ 4,242	\$ 605
Less valuation allowance	-	(276)
Balance at end of year, net	\$ 4,242	\$ 329

Changes in the valuation allowance for OREO are as follows:

	December 31, 2011	December 31, 2010
	(in Thousands)	
Balance at beginning of year	\$ 276	\$ -
Valuation allowance	-	276
Charge-offs	(276)	-
Recoveries	-	-
Balance at end of year	\$ -	\$ 276

Expenses applicable to OREO, other than the valuation allowance, were \$65,000 and \$44,000 for the years ended December 31, 2011 and 2010, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. Premises and Equipment

Bank premises and equipment are summarized as follows:

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
	(in Thousands)	
Leasehold improvements	\$ 15,267	\$ 15,110
Buildings	176	177
Land	9	9
Construction and fixed assets in progress	25	24
Furniture and equipment	5,080	4,881
Computer software	1,640	1,536
	<u>\$ 22,197</u>	<u>\$ 21,737</u>
Less accumulated depreciation and amortization	11,505	9,955
	<u>\$ 10,692</u>	<u>\$ 11,782</u>

Depreciation and amortization expense included in the operating expenses amounted to \$1,554,000 in 2011 and \$1,672,000 in 2010.

7. Deposits

The aggregate amount of time deposits with a minimum balance of \$100,000 was \$92,756,000 at December 31, 2011 and \$117,540,000 at December 31, 2010.

Brokered deposits totaled \$42,387,000 and \$55,034,000 at December 31, 2011 and 2010, respectively. As of year-end 2011, \$30,883,000 of these brokered deposits are reciprocal relationships established under the Certificate of Deposit Account Registry Service (CDARS)TM, whereby depositors can obtain FDIC insurance on deposits up to \$50 million. The remaining brokered deposits of \$11,504,000 represent bankruptcy trustee deposits placed through an agreement entered during the third quarter of 2011 with Financial Software Solutions, L.L.C., which provides its TrusteSolutionsTM system to the bankruptcy trustees.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At December 31, 2011, the scheduled maturities of time deposits are as follows:

		Scheduled Maturities at December 31, 2011
	\$	(in thousands)
2012	\$	118,439
2013		3,770
2014		2,593
2015		2,285
2016		4,355
	\$	131,442

8. Income Taxes

The Bank files tax returns in the U.S. federal jurisdiction and the Commonwealth of Virginia. With few exceptions, the Bank is no longer subject to U.S. federal and state tax examinations by tax authorities for years prior to 2008.

Net deferred tax assets consist of the following components as of December 31, 2011 and December 31, 2010:

		2011		2010
	\$	(in Thousands)	\$	(in Thousands)
Deferred tax assets:				
Alternative minimum tax	\$	58	\$	-
Allowance for loan losses		1,154		1,169
Non-accrual loan interest		3		57
Stock option/grant expense		293		261
Start-up expenses		1		1
Home equity closing costs		68		74
Deferred OREO expense		22		95
Deferred compensation expense		9		7
Depreciation		256		945
	\$	1,864	\$	2,609
Deferred tax liabilities:				
Securities available for sale	\$	886	\$	472
Deferred loan costs		35		4
Investment from subsidiary income		9		8
	\$	930	\$	484
	\$	934	\$	2,125

The provision for income taxes charged to operations for years ended December 31, 2011 and 2010 consists of the following:

		2011		2010
	\$	(in Thousands)	\$	(in Thousands)
Current tax expense	\$	155	\$	2,355
Deferred tax (benefit)		777		(285)
	\$	932	\$	2,070

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate to pretax income for the years ended December 31, 2011 and 2010 due to the following:

		2011		2010
	\$	(in Thousands)	\$	(in Thousands)
Computed "expected" tax expense	\$	1,113	\$	2,074
Increase (decrease) in income taxes resulting from:				
Tax-exempt interest income		(37)		(31)
Tax-exempt income from Bank				
Owned Life Insurance (BOLI)		(203)		(72)
Stock option expense		42		79
Social dues		9		8
Other		8		12
	\$	932	\$	2,070

9. Commitments and Contingent Liabilities

In the normal course of business, there are various outstanding commitments and contingent liabilities, which are not reflected in the accompanying financial statements. The Bank does not anticipate any material loss as a result of these transactions.

As a member of the Federal Reserve System, the Bank is required to maintain certain average clearing balances. Those balances include amounts on deposit with the Federal Reserve. For the final weekly reporting period in the years ended December 31, 2011 and December 31, 2010, the amounts of daily average required balances were \$573,000 and \$447,000, respectively.

At December 31, 2011, the Bank had leased certain of its banking and operations offices under operating lease agreements on terms ranging from 1 to 20 years with renewal options. Rent expense charged to operations under operating lease agreements totaled \$1,153,000 in 2011 and \$1,124,000 in 2010.

The following is a schedule of future minimum rental payments required under non-cancelable operating leases that have initial or remaining terms in excess of one year as of December 31, 2011:

		(in Thousands)
2012	\$	1,052
2013		959
2014		810
2015		790
2016		689
Thereafter		4,135
	\$	8,435

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. Financial Instruments With Off-Balance Sheet Risk and Credit 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. These financial instruments consist primarily of commitments to extend credit and standby letters of credit. In addition to the amounts shown below, the Bank has extended commitment letters at December 31, 2011 in the amount of \$12,219,000 to various borrowers. At December 31, 2010, commitment letters totaled \$11,247,000. Commitment letters are done in the normal course of business and typically expire after 120 days. All of these off-balance-sheet instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

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

	<u>Notional Amount</u>	
	<u>December 31, 2011</u>	<u>December 31, 2010</u>
Financial instruments whose		
contract amounts represent credit risk	(in Thousands)	
Unfunded lines-of-credit	\$106,740	\$89,166
Letters of credit	3,984	5,051
Total	<u>\$110,724</u>	<u>\$94,217</u>

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral normally consists of real property.

Standby letters of credit are conditional commitments by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds real estate and bank deposits as collateral supporting those commitments for which collateral is deemed necessary.

The Bank has approximately \$135,000 in deposits in other financial institutions in excess of amounts insured by the Federal Deposit Insurance Corporation (FDIC) at December 31, 2011.

11. Related Party Transactions

During 2011, the Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families and affiliated companies in which they are principal shareholders (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Related parties were indebted to the Bank for loans totaling \$4,873,000 and \$6,514,000 at December 31, 2011 and 2010, respectively. During 2011, total principal additions were \$2,632,000 and total principal payments were \$3,253,000. Additionally, principal balances of \$1,020,000 were reduced due to the resignations of directors during 2011.

In 2011, the Bank had business dealings with companies owned by directors of the Bank. Expenditures made to these companies in 2011 include rental expenditures of \$450,000 (including reimbursements for taxes, insurance, and other expenses), paid to an entity for which a director of the Bank is an owner. For another property owned by an entity in which a different director has a beneficial interest, the Bank had a ground lease and paid rent of \$88,000 in 2011. In the first quarter of 2012, VNB purchased this real estate for \$1,200,000, and the approximate dollar value of the interest of Mr. Craig individually and his immediate family members, without regard to the amount of profit or loss, was \$200,000 and \$400,000, respectively. Monthly rent for both properties was a fair market rate as verified by an independent third-party appraisal. Additionally, the Bank paid \$127,000 for assistance with the Bank's marketing and advertising programs to a marketing and advertising agency of which a director is an owner. Some portion of the payments to this agency may have been used, in turn, to pay third parties for legitimate business expenses incurred on behalf of the Bank.

12. Capital Requirements

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2011 and 2010, that the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2011, the most recent notification from the Office of the Comptroller of the Currency categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Bank's actual capital amounts and ratios as of December 31, 2011, are presented in the following table:

	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u> (in Thousands)	<u>Ratio</u>	<u>Amount</u> (in Thousands)	<u>Ratio</u>	<u>Amount</u> (in Thousands)	<u>Ratio</u>
Total Capital						
(To Risk Weighted Assets)	\$50,942	14.35%	\$28,404	8.00%	\$35,505	10.00%
Tier 1 Capital						
(To Risk Weighted Assets)	\$47,201	13.29%	\$14,202	4.00%	\$21,303	6.00%
Tier 1 Capital						
(To Average Assets)	\$47,201	10.28%	\$18,361	4.00%	\$22,951	5.00%

The Bank's actual capital amounts and ratios as of December 31, 2010, are presented in the following table:

	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u> (in Thousands)	<u>Ratio</u>	<u>Amount</u> (in Thousands)	<u>Ratio</u>	<u>Amount</u> (in Thousands)	<u>Ratio</u>
Total Capital						
(To Risk Weighted Assets)	\$48,334	14.23%	\$27,172	8.00%	\$33,965	10.00%
Tier 1 Capital						
(To Risk Weighted Assets)	\$44,604	13.13%	\$13,586	4.00%	\$20,379	6.00%
Tier 1 Capital						
(To Average Assets)	\$44,604	10.26%	\$17,384	4.00%	\$21,730	5.00%

13. Dividend Restrictions

Federal regulations limit the amount of dividends which the Bank can pay without obtaining prior approval. The amount of cash dividends that the Bank may pay is limited

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

to current year earnings plus retained net profits for the two preceding years. In addition, dividends paid by the Bank would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements. At December 31, 2011, the maximum amount available to the Bank for cash dividends was \$8,319,000. The Bank paid no cash dividends during 2011 or 2010. However, on May 16, 2011, the Board of Directors declared a 15% stock dividend. The stock dividend was paid on June 30, 2011 to shareholders of record at the close of business on June 15, 2011. As a result of the stock dividend, each shareholder received 0.15 shares of Common Stock for every share of Common Stock held as of the record date.

14. Fair Value Measurements

Determination of Fair Value

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

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

Fair Value Hierarchy

In accordance with this guidance, the Bank groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 – Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 – Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Bank to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the financial statements:

Securities Available For Sale

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

The following table presents the balances measured at fair value on a recurring basis as of December 31, 2011:

Description	<u>Fair Value Measurements at December 31, 2011 Using:</u>			
	<u>Balance as of December 31, 2011</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets:	(in Thousands)	(in Thousands)	(in Thousands)	(in Thousands)
U.S. Government agencies	\$ <u>84,150</u>	\$ <u>—</u>	\$ <u>84,150</u>	\$ <u>—</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the balances measured at fair value on a recurring basis as of December 31, 2010:

Description	<u>Fair Value Measurements at December 31, 2010 Using:</u>			
	<u>Balance as of December 31, 2010</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets:	(in Thousands)	(in Thousands)	(in Thousands)	(in Thousands)
U.S. Government agencies	\$ <u>54,520</u>	\$ <u>—</u>	\$ <u>54,520</u>	\$ <u>—</u>

Certain financial assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Bank to measure certain financial assets recorded at fair value on a nonrecurring basis in the financial statements:

Other Real Estate Owned

Certain assets such as other real estate owned (OREO) are measured at fair value less cost to sell. The value of real estate collateral would be determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Bank using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value would be considered Level 3. Currently, the Bank has five OREO properties carried at a balance of \$4,242,000 as of December 31, 2011.

Impaired Loans

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value would be measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The value of real estate collateral would be determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Bank using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the real estate property is over two years old, then the fair value would be considered Level 3. The value of business equipment would

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

be based upon an outside appraisal if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral would be based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the Allowance for Loan Losses would be measured at fair value on a nonrecurring basis. Any fair value adjustments would be recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income. The Bank had \$3,124,000 in impaired loans as of December 31, 2011. None of these impaired loans required a valuation allowance after consideration was given for each borrowing as to the fair value of the collateral on the loan or the present value of expected future cash flows from the customer.

The following table presents the Bank's assets that were measured at fair value on a nonrecurring basis as of December 31, 2011:

<u>Description</u>	<u>Fair Value Measurements at December 31, 2011 Using:</u>			
	<u>Net Carrying Value as of December 31, 2011</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets:	(in Thousands)	(in Thousands)	(in Thousands)	(in Thousands)
Other Real Estate Owned (OREO)	\$ <u>4,242</u>	\$ <u>—</u>	\$ <u>4,242</u>	\$ <u>—</u>

The following table presents the Bank's assets that were measured at fair value on a nonrecurring basis as of December 31, 2010:

<u>Description</u>	<u>Fair Value Measurements at December 31, 2010 Using:</u>			
	<u>Net Carrying Value as of December 31, 2010</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets:	(in Thousands)	(in Thousands)	(in Thousands)	(in Thousands)
Other Real Estate Owned (OREO)	\$ <u>329</u>	\$ <u>—</u>	\$ <u>329</u>	\$ <u>—</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Cash and Short-Term Investments

For those short-term instruments, including cash, due from banks and federal funds sold, the carrying amount is a reasonable estimate of fair value.

Interest bearing deposits

The carrying amounts of interest bearing deposits maturing within ninety days approximate their fair value.

Securities

Fair values for securities, excluding restricted securities, are based on quoted market prices.

Loan Receivables

The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Bank Owned Life Insurance

The carrying amounts of Bank Owned Life Insurance approximate fair value.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Deposit Liabilities

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

Short-Term Borrowings

The carrying amounts of securities sold under agreements to repurchase approximate fair value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Off-Balance Sheet Financial Instruments

At December 31, 2011 and 2010, the fair values of loan commitments and standby letters of credit are immaterial. Therefore, they have not been included in the following table.

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

	December 31, 2011		December 31, 2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in Thousands)		(in Thousands)	
Financial Assets:				
Cash and short-term investments	\$57,044	\$57,044	\$73,526	\$73,526
Securities	90,138	90,231	62,041	62,169
Loans, net	288,791	285,793	294,901	293,294
Bank owned life insurance	6,869	6,869	5,061	5,061
Accrued interest receivable	1,369	1,369	1,354	1,354
Financial Liabilities:				
Demand deposits and interest-bearing transaction accounts	\$280,426	\$280,426	\$254,689	\$254,689
Certificates of deposit	131,442	131,435	152,999	153,069
Securities sold under agreements to repurchase	2,623	2,623	1,801	1,801
Accrued interest payable	213	213	265	265

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

15. Other Expenses

The Bank had the following other expenses as of the dates indicated:

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
	(in Thousands)	
FDIC deposit insurance assessment	\$ 353	\$ 668
Marketing, advertising and promotion	620	668
Professional fees	479	516
Third party processing	742	628
Telecommunications	291	298
ATM, debit and credit card expense	303	289
OREO writedown expense	-	276
Virginia franchise tax	278	247
Other	1,469	1,388
	<u>\$ 4,535</u>	<u>\$ 4,978</u>

16. Employee Benefit Plans

The Bank has a 401(k) plan available to all employees who are at least 18 years of age. Employees are able to elect the amount to contribute, not to exceed a maximum amount as determined by IRS regulation. The Bank has agreed to match 50% of every dollar contributed by employees up to a maximum of 6% of annual compensation.

“Vesting” refers to the rights of ownership to the assets in the 401(k) accounts. Bank contributions to the plan are vested by the employees according to the following schedule: 50% after two years of service, 75% after three years of service and 100% after four years of service. Employee contributions to the plan are always 100% vested. The Bank contributed \$178,000 to the plan in 2011 and \$147,000 in 2010.

17. Stock Incentive Plans

The Bank’s shareholders approved the Virginia National Bank 1998 Stock Incentive Plan at the 1999 Annual Meeting of Shareholders. The plan reserved 430,100 shares of Common Stock, an amount equal to 20% of the aggregate number of shares sold in the June, 1998 Common Stock offering. The plan covered both employee and director stock options. The 1998 Plan expired in June, 2008. No new grants will be issued under this Plan. At December 31, 2011, 414,327 stock options had been granted under this plan, net of forfeitures.

At the Annual Meeting of Shareholders of Virginia National Bank, held on May 21, 2003, shareholders approved the Virginia National Bank 2003 Stock Incentive Plan. An aggregate of 128,369 shares are presently issuable under the 2003 Plan. Forfeitures return to the plan as ungranted. At December 31, 2011, 127,240 stock options had been issued under this plan, net of forfeitures. There are 1,129 shares still available under this plan.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At the Annual Meeting of Shareholders of Virginia National Bank, held on May 16, 2005, shareholders approved the Virginia National Bank 2005 Stock Incentive Plan. An aggregate of 230,000 shares are presently issuable under the 2005 Plan. Forfeitures return to the plan as ungranted. At December 31, 2011, 189,174 stock options had been issued under this plan, net of forfeitures. There are 40,826 shares still available under this plan.

All three stock plans provide for granting of both incentive and nonqualified stock options. The option price of incentive options will not be less than the fair market value of the stock at the time an option is granted. Nonqualified options may be granted at a price established by the Board of Directors, including prices less than the fair market value on the date of grant. All options expire ten years from the grant date.

Changes in the stock options outstanding related to the 1998 Plan, the 2003 Plan and the 2005 Plan are summarized as follows:

	<u>2011</u>	
	<u>Number of</u>	<u>Weighted</u>
	<u>Shares</u>	<u>Average</u>
		<u>Exercise</u>
		<u>Price</u>
Outstanding at beginning of year	272,560	\$26.04
Granted	6,325	\$15.85
Exercised	--	--
Forfeited	(575)	\$16.09
Expired	--	--
Outstanding at end of year	278,310	\$25.83
Options exercisable at year-end	233,280	\$26.91
Weighted-average fair value of options granted during the year	\$7.39	

The fair value of each grant is estimated at the grant date using the Black-Scholes option-pricing model. The estimates were calculated using the following weighted-average assumptions: price volatility of 44.45%; risk-free interest rate of 2.47%; no dividend rate; and an expected option life of 6.25 years. Price volatility assumptions were based on the historical volatility of the price of Virginia National Bank's Common Stock. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grants. Expected lives are based on historical experience. The dividend rate is based on the Bank's history of not paying a cash dividend.

For the year ended December 31, 2011, the Bank recognized \$223,232 in compensation expense for stock options. As of December 31, 2011, there was \$206,269 in unamortized compensation expense remaining to be recognized in future reporting periods through 2015.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

There was \$1,230 in aggregate intrinsic value for options outstanding and \$305 in aggregate intrinsic value for options exercisable at December 31, 2011. The aggregate intrinsic value of options outstanding at December 31, 2010 was \$750.

The total intrinsic value of options exercised during the year ended December 31, 2011 was \$0, as no options were exercised in the period.

Summary information pertaining to options outstanding at December 31, 2011 is as follows:

Exercise Price	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$11.74 to 20.00	75,766	4.5 Years	\$17.37	48,675	\$17.47
20.01 to 30.00	98,870	5.3 Years	24.68	84,806	24.96
30.01 to 36.74	103,674	4.4 Years	33.11	99,799	33.18
Total	<u>278,310</u>	4.7 Years	\$25.83	<u>233,280</u>	\$26.91

No restricted stock awards were granted in 2011. The Bank granted 1,150 restricted stock awards (non-vested shares) in 2010. The requisite service period for these awards is four years. The Bank recorded \$39,753 and \$59,184 in compensation expense related to grants in 2011 and 2010, respectively.

The following table summarizes restricted stock activity at December 31, 2011:

	<u>Number of Shares</u>	<u>Average Grant-Date Fair Value</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at beginning of year	2,875	\$20.03	\$37,500
Issued	-	-	
Vested	2,012	\$23.36	
Non-vested at end of year	<u>863</u>	\$12.18	\$11,970

The weighted average remaining contractual term for non-vested awards at December 31, 2011 was 1.9 years. As of December 31, 2011, there was \$9,632 of total unrecognized compensation expense related to the non-vested awards.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. Earnings Per Share

The following shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of diluted potential common stock. Potential dilutive common stock has no effect on income available to common shareholders. All per share information has been restated to reflect a 1.15 to 1.00 stock dividend paid on June 30, 2011.

	2011		2010	
	<u>Shares</u>	<u>Per Share Amount</u>	<u>Shares</u>	<u>Per Share Amount</u>
Basic EPS	2,690,220	\$0.87	2,689,258	\$1.50
Effect of dilutive securities and stock options	2,712		3,599	
Diluted EPS	2,692,932	\$0.87	2,692,857	\$1.50

In 2011, stock options representing 274,856 average shares were not included in the calculation of earnings per share, as their effect would have been antidilutive. Stock options representing 272,564 average shares were similarly not included in 2010.

19. Segment Reporting

The Bank has two reportable segments, the commercial bank and VNBTrust.

Commercial banking involves making loans and generating deposits from individuals and businesses. Loan fee income, service charges from deposit accounts, and other non-interest-related fees such as automatic teller machine fees and safe deposit box fees generate additional income for the commercial bank.

VNBTrust services include investment management, trust account administration, and estate planning. VNBTrust receives fees on both a fixed basis and a performance basis for the provision of these services.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Each reportable segment is a strategic business unit that offers different products and services. They are managed separately because each segment appeals to different markets and, accordingly, requires different technology and marketing strategies.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Segment information as of, and for the years ended, December 31, 2011 and 2010, is shown in the following table:

<u>2011</u>	<u>Commercial</u>		<u>Consolidated</u>
(in Thousands)	<u>Bank</u>	<u>VNBTrust</u>	<u>Totals</u>
Net interest income	\$ 16,064	\$ 11	\$ 16,075
Provision for loan losses	535	-	535
Non-interest income	2,529	2,577	5,106
Non-interest expense	15,296	2,077	17,373
Income before income taxes	2,762	511	3,273
Provision for income taxes	754	178	932
Net income	2,008	333	2,341
Total assets	457,367	6,699	464,066

<u>2010</u>	<u>Commercial</u>		<u>Consolidated</u>
(in Thousands)	<u>Bank</u>	<u>VNBTrust</u>	<u>Totals</u>
Net interest income	\$ 16,683	\$ 9	\$ 16,692
Provision for loan losses	314	-	314
Non-interest income	2,193	5,611	7,804
Non-interest expense	15,665	2,417	18,082
Income before income taxes	2,897	3,203	6,100
Provision for income taxes	956	1,114	2,070
Net income	1,941	2,089	4,030
Total assets	450,547	7,750	458,297

20. Subsequent Events

In preparing these financial statements, the Bank has evaluated events and transactions for potential recognition or disclosure through the date the financial statements were issued.



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
Virginia National Bank and Subsidiary
Charlottesville, Virginia

We have audited the accompanying consolidated balance sheets of Virginia National Bank and subsidiary as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Bank is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Virginia National Bank and subsidiary as of December 31, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 26, 2012

Item 9 – CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None

Item 9A – CONTROLS AND PROCEDURES.

Bank management is responsible for establishing and maintaining adequate control over financial reporting, as defined in Rules 13a – 15(f) under the Exchange Act. The Bank’s internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes, in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a significant deficiency (as defined in Public Company Accounting Oversight Board Auditing Standard No. 2), or a combination of significant deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by management or employees in the normal course of performing their assigned functions.

Management assessed the effectiveness of the Bank’s internal control over financial reporting as of December 31, 2011. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in “Internal Control-Integrated Framework.” Based on this assessment, management believes that, as of December 31, 2011, the Bank’s internal control over financial reporting was effective.

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

Item 9B – OTHER INFORMATION.

None

Part III

Item 10 – DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE.

Information is incorporated by reference from the Bank’s 2012 Definitive Proxy Statement (“Proxy Statement”) to be filed within 120 days of the end of the fiscal year.

Item 11 – EXECUTIVE COMPENSATION.

This information is incorporated by reference from the “Executive Compensation” section of the Bank’s Definitive Proxy Statement to be filed within 120 days of the end of the fiscal year.

Item 12 – SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Other than as set forth below, this information is incorporated by reference from Note 17, “Stock Incentive Plans,” contained in the *Notes to Consolidated Financial Statements* of this Form 10-K and from the “Ownership of VNB Common Stock” section of the Bank’s Definitive Proxy Statement to be filed within 120 days of the end of the fiscal year.

The following table summarizes information, as of December 31, 2011, relating to the Bank’s 1998 Stock Incentive Plan, 2003 Stock Incentive Plan and 2005 Stock Incentive Plan:

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	278,310	\$25.83	41,955
Equity compensation plans not approved by security holders	--	--	--
Total	<u>278,310</u>	<u>\$25.83</u>	<u>41,955</u>

Item 13 – CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

This information is incorporated by reference from the “Information about the Board of Directors and Board Committees” and “Related Party Transaction and Other Information Related to Directors” sections of the Bank’s Definitive Proxy Statement to be filed within 120 days of the end of the fiscal year. For further information, see Note 11 of the *Notes to Consolidated Financial Statements*.

Item 14 – PRINCIPAL ACCOUNTING FEES AND SERVICES.

This information is incorporated by reference from the “Independent Auditors” section of the Bank’s Definitive Proxy Statement to be filed within 120 days of the end of the fiscal year.

Part IV

Item 15 – EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) Exhibit Index:

<u>Exhibit Number</u>	<u>Description of Exhibit</u>
3.1	Articles of Association of Virginia National Bank, as amended*
3.2	Bylaws of Virginia National Bank, as amended
4.0	Form of Common Stock Certificate of Virginia National Bank**
10.1	Form of Virginia National Bank 1998 Stock Incentive Plan** Form of Virginia National Bank 2003 Stock Incentive Plan*** Form of Virginia National Bank 2005 Stock Incentive Plan****
21.0	Subsidiaries of the Registrant*****
22.0	Proxy Statement for Annual Meeting on May 21, 2012, to be filed within 120 days of the end of the fiscal year
31.1	302 Certification of Principal Executive Officer
31.2	302 Certification of Principal Financial Officer
32.1	906 Certification

* Incorporated herein by reference from Virginia National Bank's 2009 Annual Report on Form 10-K, filed with the Office of the Comptroller of the Currency's March 26, 2010.

** Incorporated herein by reference from Virginia National Bank's Registration Statement on Form SB-2, filed with the Office of the Comptroller of the Currency's Southeastern District Office on May 21, 1998, as amended.

*** Incorporated herein by reference from Virginia National Bank's Definitive Proxy Statement, filed with the Office of the Comptroller of the Currency on April 24, 2003.

**** Incorporated herein by reference from Virginia National Bank's Definitive Proxy Statement, filed with the Office of the Comptroller of the Currency on April 22, 2005.

***** Refer to page 4 for a discussion of Virginia National Bank's direct and indirect subsidiaries.

EXHIBIT 31.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

I, Glenn W. Rust, certify that:

1. I have reviewed this annual report on Form 10-K of Virginia National Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such disclosure over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 26, 2012

/s/ Glenn W. Rust
Glenn W. Rust
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, Ronald E. Baron, certify that:

1. I have reviewed this annual report on Form 10-K of Virginia National Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such disclosure over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 26, 2012

/s/Ronald E. Baron
Ronald E. Baron
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED PURSUANT
TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Virginia National Bank (the "Bank") on Form 10-K for the period ending December 31, 2011 as filed with the Office of the Comptroller of the Currency on the date hereof (the "Report"), the undersigned Chief Executive Officer and Chief Financial Officer of the Bank hereby certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002 that, based on their knowledge and belief: (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Bank as of and for the periods covered in the Report.

/s/ Glenn W. Rust

Glenn W. Rust, Principal Executive Officer

/s/ Ronald E. Baron

Ronald E. Baron, Principal Financial Officer

March 26, 2012