

AMERICAN RIVER BANKSHARES

Form 10-K

February 28, 2014

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

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

For the fiscal year ended December 31, 2013

or

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

For the transition period from to

Commission File No. 0-31525

AMERICAN RIVER BANKSHARES

(Exact name of registrant as specified in its charter)

California 68-0352144  
State or other jurisdiction of (IRS Employer Identification No.)  
incorporation or organization

3100 Zinfandel Drive, Rancho Cordova, California 95670  
(Address of principal executive offices) (Zip code)  
Registrant's telephone number, including area code 916-851-0123

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

Title of Each Class	Name of Each Exchange On Which Registered
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Common Stock, no par value	NASDAQ Global Select Market
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Securities registered pursuant to Section 12(g) of the Act:

None

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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 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark 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 Act). Yes  No

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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 the last business day of the registrant's most recently completed second fiscal quarter. \$66,455,000.

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

As of February 26, 2014, the registrant's no par value Common Stock totaled 8,188,409 shares outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

The following documents are incorporated by reference into this Form 10-K: Part III, Items 10 through 14 from Registrant's definitive proxy statement for the 2014 annual meeting of shareholders.

**AMERICAN RIVER BANKSHARES**

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FOR YEAR ENDED DECEMBER 31, 2013**

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## **PART I**

### **Item 1. Business.**

#### **Cautionary Statements Regarding Forward-Looking Statements**

Certain matters discussed or incorporated by reference in this Annual Report on Form 10-K including, but not limited to, matters described in “Item 7 - Management’s Discussion and Analysis of Financial Condition and Results of Operations,” are “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, Section 27A of the Securities Act of 1933, as amended, and subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements may contain words related to future projections including, but not limited to, words such as “believe,” “expect,” “anticipate,” “intend,” “may,” “will,” “should,” “could,” “would,” and variations of those words and similar words that are subject to risks, uncertainties and other factors that could cause actual results to differ significantly from those projected. Factors that could cause or contribute to such differences include, but are not limited to, the following:

the duration of financial and economic instability and actions taken by the United States Congress and governmental agencies, including the United States Department of the Treasury, to deal with challenges to the U.S. financial system;

the risks presented by a continued economic recession, which could adversely affect credit quality, collateral values, including real estate collateral, investment values, liquidity and loan originations and loan portfolio delinquency rates;

variances in the actual versus projected growth in assets and return on assets;

potential continued or increasing loan and lease losses;

potential increasing levels of expenses associated with resolving nonperforming assets as well as regulatory changes;

changes in the interest rate environment including interest rates charged on loans, earned on securities investments and paid on deposits and other borrowed funds;

competitive effects;

potential declines in fee and other noninterest income earned associated with economic factors as well as regulatory changes;

general economic conditions nationally, regionally, and within our operating markets could be less favorable than expected or could have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth at historical rates and maintain the quality of our earning assets;

changes in the regulatory environment including government intervention in the U.S. financial system;

changes in business conditions and inflation;

changes in securities markets, public debt markets, and other capital markets;

potential data processing and other operational systems failures or fraud;

potential decline in real estate values in our operating markets;

the effects of uncontrollable events such as terrorism, the threat of terrorism or the impact of the military conflicts in Afghanistan and Iraq and the conduct of the war on terrorism by the United States and its allies, worsening financial and economic conditions, natural disasters, and disruption of power supplies and communications;

changes in accounting standards, tax laws or regulations and interpretations of such standards, laws or regulations;

projected business increases following any future strategic expansion could be lower than expected;

the goodwill we have recorded in connection with acquisitions could become impaired, which may have an adverse impact on our earnings;

the reputation of the financial services industry could experience further deterioration, which could adversely affect our ability to access markets for funding and to acquire and retain customers;

the efficiencies we may expect to receive from any investments in personnel and infrastructure may not be realized;  
and

downgrades in the credit rating of the United States by credit rating agencies.

The factors set forth under “Item 1A-Risk Factors” in this report and other cautionary statements and information set forth in this report should be carefully considered and understood as being applicable to all related forward-looking statements contained in this report, when evaluating the business prospects of the Company and its subsidiaries.

Forward-looking statements are not guarantees of performance. By their nature, they involve risks, uncertainties and assumptions. The future results and shareholder values may differ significantly from those expressed in these forward-looking statements. You are cautioned not to put undue reliance on any forward-looking statement. Any such statement speaks only as of the date of this report, and in the case of any documents that may be incorporated by reference, as of the date of those documents. We do not undertake any obligation to update or release any revisions to any forward-looking statements, to report any new information, future event or other circumstances after the date of this report or to reflect the occurrence of unanticipated events, except as required by law. However, your attention is directed to any further disclosures made on related subjects in our subsequent reports filed with the Securities and Exchange Commission (the “SEC”) on Forms 10-K, 10-Q and 8-K.

## **Introduction**

American River Bankshares (the “Company”) is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company was incorporated under the laws of the State of California in 1995. As a bank holding company, the Company is authorized to engage in the activities permitted under the Bank Holding Company Act of 1956, as amended, and regulations thereunder. Its principal office is located at 3100 Zinfandel Drive, Suite 450, Rancho Cordova, California 95670 and its telephone number is (916) 851-0123.

The Company owns 100% of the issued and outstanding common shares of its banking subsidiary, American River Bank, and American River Financial, a California corporation which has been inactive since its incorporation in 2003.

American River Bank was incorporated and commenced business in Fair Oaks, California, in 1983 and thereafter moved its headquarters to Sacramento, California in 1985. American River Bank operates four full service offices in Sacramento County including the main office located at 1545 River Park Drive, Suite 107, Sacramento and branch offices in Sacramento and Fair Oaks; one full service office in Placer County, located in Roseville; two full service offices in Sonoma County in Healdsburg and Santa Rosa; and three full service offices in Amador County in Jackson, Pioneer, and Ione. In addition, American River Bank operates two loan production offices located in Alameda and Santa Clara counties. In 2000, North Coast Bank was acquired by the Company as a separate bank subsidiary. Effective December 31, 2003, North Coast Bank was merged with and into American River Bank. On December 3, 2004, the Company acquired Bank of Amador located in Jackson, California. Bank of Amador was merged with and into American River Bank.

American River Bank’s deposits are insured by the Federal Deposit Insurance Corporation (“FDIC”) up to applicable legal limits. On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The Dodd-Frank Act includes a permanent increase to \$250,000 as the maximum FDIC insurance limit per depositor retroactive to January 1, 2008 and the extension of unlimited FDIC insurance for noninterest-bearing transaction accounts effective December 31, 2010 through December 31, 2012. On November 9, 2010, the FDIC implemented a final rule to permanently increase the maximum insurance limit to \$250,000 under the Dodd-Frank Act. The unlimited insurance coverage for noninterest bearing transaction accounts was not extended and terminated on December 31, 2012. The \$250,000 maximum deposit insurance amount per depositor remains in effect.

American River Bank does not offer trust services or international banking services and does not plan to do so in the near future. American River Bank’s primary business is serving the commercial banking needs of small to mid-sized businesses within those counties listed above. American River Bank accepts checking and savings deposits, offers money market deposit accounts and certificates of deposit, makes secured and unsecured commercial, secured real estate, and other installment and term loans and offers other customary banking services. American River Bank also



conducts lease financing for most types of business equipment, from computer software to heavy earth-moving equipment. American River Bank owns 100% of two inactive companies, ARBCO and American River Mortgage. ARBCO was formed in 1984 to conduct real estate development and has been inactive since 1995. American River Mortgage has been inactive since its formation in 1994.

During 2013, the Company conducted no significant activities other than holding the shares of its subsidiaries. However, it is authorized, with the prior approval of the Board of Governors of the Federal Reserve System (the “Board of Governors”), the Company’s principal regulator, to engage in a variety of activities which are deemed closely related to the business of banking.

The common stock of the Company is registered under the Securities Exchange Act of 1934, as amended, and is listed and traded on the Nasdaq Global Select Market under the symbol “AMRB.”

At December 31, 2013, the Company had consolidated assets of \$593 million, deposits of \$484 million and shareholders’ equity of \$87 million.

## **General**

The Company is a regional bank holding company headquartered in Sacramento, California. The principal communities served are located in Sacramento, Placer, Yolo, El Dorado, Sonoma, and Amador counties. In addition, during 2013, the Company opened two loan production offices in Alameda and Contra Costa Counties. The Company generates most of its revenue by providing a wide range of products and services to small and middle-market businesses and individuals. The Company’s principal source of revenue comes from interest income. Interest income is derived from interest and fees on loans and leases, interest on investments (principally government securities), and Federal funds sold (funds loaned on a short-term basis to other banks). For the year ended December 31, 2013, these sources comprised 75.2%, 24.8%, and zero, respectively, of the Company’s interest income.

American River Bank’s deposits are not received from a single depositor or group of affiliated depositors, the loss of any one of which would have a materially adverse effect on the business of the Company. A material portion of American River Bank’s deposits are not concentrated within a single industry or group of related industries.

As of December 31, 2013 and December 31, 2012, American River Bank held \$29,000,000 in certificates of deposit for the State of California. In connection with these deposits, American River Bank is generally required to pledge securities to secure such deposits, except for the first \$250,000 insured by the FDIC.

Based upon the most recent information made available by the FDIC through June 30, 2013, American River Bank competes with approximately 35 other banking or savings institutions in Sacramento County, 29 in Placer County, 19 in Sonoma County and 6 in Amador County. American River Bank’s market share of FDIC insured deposits in the service areas of Sacramento County was 1.1%, in Placer County was approximately 0.6%, in Sonoma County was approximately 0.4%, and in Amador County was approximately 14.8% (based upon the most recent information made available by the FDIC through June 30, 2013).

## **Employees**

At December 31, 2013, the Company and its subsidiaries employed 101 persons on a full-time equivalent basis. The Company believes its employee relations are good.

## **Website Access**

The Company maintains a website where certain information about the Company is posted. Through the website, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments thereto, as well as Section 16 Reports and amendments thereto, are available as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. These reports are free of charge and can be accessed

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through the address [www.americanriverbank.com](http://www.americanriverbank.com) by accessing the *Investor Relations* link, then the *SEC Filings* link located at that address. Once you have selected the *SEC Filings* link you will have the option to access the Section 16 Reports or the reports filed on Forms 10-K, 10-Q and 8-K by the Company by selecting the appropriate link.

## Supervision and Regulation

### General

The common stock of the Company is subject to the registration requirements of the Securities Act of 1933, as amended, and the qualification requirements of the California Corporate Securities Law of 1968, as amended. The Company is also subject to the periodic reporting requirements of Section 13 of the Securities Exchange Act of 1934, as amended, which include, but are not limited to, annual, quarterly and other current reports with the SEC.

American River Bank is licensed by the California Commissioner of the Department of Business Oversight (the “Commissioner”), and its deposits are insured by the FDIC up to the applicable legal limits. Beginning December 31, 2010, through December 31, 2012, all noninterest-bearing transaction accounts were fully insured, regardless of the balance of the account, at all FDIC-insured institutions. American River Bank has chosen not to become a member of the Federal Reserve System. Consequently, American River Bank is subject to the supervision of, and is regularly examined by, the Commissioner and the FDIC. The supervision and regulation includes comprehensive reviews of all major aspects of American River Bank’s business and condition, including its capital ratios, allowance for possible loan and lease losses and other factors. However, no inference should be drawn that such authorities have approved any such factors. American River Bankshares and American River Bank are required to file reports with the Board of Governors, the Commissioner, and the FDIC and provide any additional information that the Board of Governors, the Commissioner, and the FDIC may require.

On July 3, 2012, the California Legislature approved and adopted a reorganization plan proposed by Governor Jerry Brown that would restructure the California government with the goal of achieving more efficient, streamlined and cost-effective government. As part of the reorganization plan, the California Department of Financial Institutions (“DFI”) and the California Department of Corporations (“DOC”) was merged into a newly created Department of Business Oversight (“DBO”) with a single commissioner in charge of the DBO. Effective July 1, 2013, the former DFI and DOC became the Division of Financial Institutions and the Division of Corporations, respectively, under the DBO. It is uncertain what effect such reorganization plan may have upon regulation of American River Bank in the future.

American River Bankshares is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the “Bank Holding Company Act”), and is registered as such with, and subject to the supervision of, the Board of Governors. The Company is required to obtain the approval of the Board of Governors before it may acquire all or substantially all of the assets of any bank, or ownership or control of the voting shares of any bank if, after giving effect to such acquisition of shares, the Company would own or control more than 5% of the voting shares of such bank. The Bank Holding Company Act prohibits the Company from acquiring any voting shares of, or interest in, all or substantially all of the assets of, a bank located outside the State of California unless such an acquisition is specifically authorized by the laws of the state in which such bank is located. Any such interstate acquisition is also subject to applicable California and federal law.

The Company, and any subsidiaries which it may acquire or organize, are deemed to be “affiliates” within the meaning of that term as defined in the Federal Reserve Act. This means, for example, that there are limitations (a) on loans by American River Bank to affiliates, and (b) on investments by American River Bank in affiliates’ stock as collateral for loans to any borrower. The Company and its subsidiaries are also subject to certain restrictions with respect to engaging in the underwriting, public sale and distribution of securities.

In addition, regulations of the Board of Governors under the Federal Reserve Act require that reserves be maintained by American River Bank in conjunction with any liability of the Company under any obligation (promissory note, acknowledgement of advance, banker’s acceptance or similar obligation) with a weighted average maturity of less than seven (7) years to the extent that the proceeds of such obligations are used for the purpose of supplying funds to

American River Bank for use in its banking business, or to maintain the availability of such funds.

### **Capital Standards**

*Risk-Based Capital.* The Board of Governors and the FDIC have adopted risk-based capital guidelines for evaluating the capital adequacy of bank holding companies and banks. The guidelines are designed to make capital requirements sensitive to differences in risk profiles among banking organizations, to take into account off-balance sheet exposures and to aid in making the definition of bank capital uniform internationally. Under the guidelines, American River Bankshares and American River Bank are required to maintain capital equal to at least 8.0% of its assets and commitments to extend credit, weighted by risk, of which at least 4.0% must consist primarily of common equity (including retained earnings) and the remainder may consist of subordinated debt, cumulative preferred stock, or a limited amount of loan and lease loss reserves.

Assets, commitments to extend credit, and off-balance sheet items are categorized according to risk and certain assets considered to present less risk than others permit maintenance of capital at less than the 8% ratio. For example, most home mortgage loans are placed in a 50% risk category and therefore require maintenance of capital equal to 4% of those loans, while commercial loans are placed in a 100% risk category and therefore require maintenance of capital equal to 8% of those loans.

Under the risk-based capital guidelines, assets reported on an institution's balance sheet and certain off-balance sheet items are assigned to risk categories, each of which has an assigned risk weight. Capital ratios are calculated by dividing the institution's qualifying capital by its period-end risk-weighted assets. The guidelines establish two categories of qualifying capital: Tier 1 capital (defined to include common shareholders' equity and noncumulative perpetual preferred stock) and Tier 2 capital which includes, among other items, limited life (and in the case of banks, cumulative) preferred stock, mandatory convertible securities, subordinated debt and a limited amount of reserve for credit losses. Tier 2 capital may also include up to 45% of the pretax net unrealized gains on certain available-for-sale equity securities having readily determinable fair values (i.e., the excess, if any, of fair market value over the book value or historical cost of the investment security). The federal regulatory agencies reserve the right to exclude all or a portion of the unrealized gains upon a determination that the equity securities are not prudently valued. Unrealized gains and losses on other types of assets, such as bank premises and available-for-sale debt securities, are not included in Tier 2 capital, but may be taken into account in the evaluation of overall capital adequacy and net unrealized losses on available-for-sale equity securities will continue to be deducted from Tier 1 capital as a cushion against risk. Each institution is required to maintain a minimum risk-based capital ratio (including Tier 1 and Tier 2 capital) of 8%, of which at least half must be Tier 1 capital.

A leverage capital standard was adopted as a supplement to the risk-weighted capital guidelines. Under the leverage capital standard, an institution is required to maintain a minimum ratio of Tier 1 capital to the sum of its quarterly average total assets and quarterly average reserve for loan losses, less intangible assets not included in Tier 1 capital. Period-end assets may be used in place of quarterly average total assets on a case-by-case basis. The Board of Governors and the FDIC have also adopted a minimum leverage ratio for bank holding companies as a supplement to the risk-weighted capital guidelines. The leverage ratio establishes a minimum Tier 1 ratio of 3% (Tier 1 capital to total assets) for the highest rated bank holding companies or those that have implemented the risk-based capital market risk measure. All other bank holding companies must maintain a minimum Tier 1 leverage ratio of 4% with higher leverage capital ratios required for bank holding companies that have significant financial and/or operational weakness, a high risk profile, or are undergoing or anticipating rapid growth.

Effective January 1, 2015, the risk-based capital regulations are amended to the extent described below in "*Basel III - New Capital and Prompt Corrective Action Regulations.*"

*Basel III – New Capital and Prompt Corrective Action Regulations.* In July 2013, the federal bank regulatory agencies issued interim final rules that revise and replace the current risk-based capital requirements in order to implement the "Basel III" regulatory capital reforms released by the Basel Committee on Banking Supervision and changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The Basel III reforms reflected in the final rules include an increase in the risk-based capital requirements and certain changes to capital components and the calculation of risk-weighted assets.

Effective January 1, 2015, banking organizations like the Company and American River Bank must comply with new minimum capital ratio requirements to be phased-in between January 1, 2015 and January 1, 2019, which would consist of the following: (i) a new common equity Tier 1 capital to total risk weighted assets ratio of 4.5%; (ii) a Tier 1 capital to total risk weighted assets ratio of 6% (increased from 4%); (iii) a total capital to total risk weighted assets ratio of 8% (unchanged from current rules); and (iv) a Tier 1 capital to adjusted average total assets ("leverage") ratio of

4%.

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In addition, a “capital conservation buffer,” is established which when fully phased-in will require maintenance of a minimum of 2.5% of common equity Tier 1 capital to total risk weighted assets in excess of the regulatory minimum capital ratio requirements described above. The 2.5% buffer will increase the minimum capital ratios to (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new buffer requirement will be phased-in between January 1, 2016 and January 1, 2019. If the capital ratio levels of a banking organization fall below the capital conservation buffer amount, the organization will be subject to limitations on (i) the payment of dividends; (ii) discretionary bonus payments; (iii) discretionary payments under Tier 1 instruments; and (iv) engaging in share repurchases.

The federal bank regulatory agencies also implemented changes to the prompt corrective action framework, which is designed to place restrictions on insured depository institutions if their capital ratios begin to show signs of weakness. These changes will take effect January 1, 2015 and will require insured depository institutions to meet the following increased capital ratio requirements in order to qualify as “well capitalized:” (i) a new common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8% (increased from 6%); (iii) a total capital ratio of 10% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 5% (increased from 4%).

Assuming the interim final rules were in effect at December 31, 2013 and based upon the Company’s capital position at December 31, 2013, management believes that the Company and American River Bank would be in compliance with the minimum capital requirements, including the fully phased-in capital conservation buffer requirement, of the interim final rules.

### **Prompt Corrective Action**

The Board of Governors and the FDIC have adopted regulations implementing a system of prompt corrective action pursuant to Section 38 of the Federal Deposit Insurance Act and Section 131 of the FDIC Improvement Act of 1991 (“FDICIA”). The regulations establish five capital categories with the following characteristics: (1) “Well capitalized” - consisting of institutions with a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 6% or greater and a leverage ratio of 5% or greater, and the institution is not subject to an order, written agreement, capital directive or prompt corrective action directive; (2) “Adequately capitalized” - consisting of institutions with a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 4% or greater and a leverage ratio of 4% or greater, and the institution does not meet the definition of a “well capitalized” institution; (3) “Undercapitalized” - consisting of institutions with a total risk-based capital ratio less than 8%, a Tier 1 risk-based capital ratio of less than 4%, or a leverage ratio of less than 4%; (4) “Significantly undercapitalized” - consisting of institutions with a total risk-based capital ratio of less than 6%, a Tier 1 risk-based capital ratio of less than 3%, or a leverage ratio of less than 3%; (5) “Critically undercapitalized” - consisting of an institution with a ratio of tangible equity to total assets that is equal to or less than 2%.

The regulations established procedures for classification of financial institutions within the capital categories, filing and reviewing capital restoration plans required under the regulations and procedures for issuance of directives by the appropriate regulatory agency, among other matters. The regulations impose restrictions upon all institutions to refrain from certain actions which would cause an institution to be classified within any one of the three “undercapitalized” categories, such as declaration of dividends or other capital distributions or payment of management fees, if following the distribution or payment the institution would be classified within one of the “undercapitalized” categories. In addition, institutions which are classified in one of the three “undercapitalized” categories are subject to certain



mandatory and discretionary supervisory actions. Mandatory supervisory actions include (1) increased monitoring and review by the appropriate federal banking agency; (2) implementation of a capital restoration plan; (3) total asset growth restrictions; and (4) limitations upon acquisitions, branch expansion, and new business activities without prior approval of the appropriate federal banking agency. Discretionary supervisory actions may include (1) requirements to augment capital; (2) restrictions upon affiliate transactions; (3) restrictions upon deposit gathering activities and interest rates paid; (4) replacement of senior executive officers and directors; (5) restrictions upon activities of the institution and its affiliates; (6) requiring divestiture or sale of the institution; and (7) any other supervisory action that the appropriate federal banking agency determines is necessary to further the purposes of the regulations. Further, the federal banking agencies may not accept a capital restoration plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. In addition, for a capital restoration plan to be acceptable, the depository institution's parent holding company must guarantee that the institution will comply with such capital restoration plan. The aggregate liability of the parent holding company under the guaranty is limited to the lesser of (i) an amount equal to 5 percent of the depository institution's total assets at the time it became undercapitalized, and (ii) the amount that is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is treated as if it were "significantly undercapitalized." FDICIA also restricts the solicitation and acceptance of and interest rates payable on brokered deposits by insured depository institutions that are not "well capitalized." An "undercapitalized" institution is not allowed to solicit deposits by offering rates of interest that are significantly higher than the prevailing rates of interest on insured deposits in the particular institution's normal market areas or in the market areas in which such deposits would otherwise be accepted.

Any financial institution which is classified as “critically undercapitalized” must be placed in conservatorship or receivership within 90 days of such determination unless it is also determined that some other course of action would better serve the purposes of the regulations. Critically undercapitalized institutions are also prohibited from making (but not accruing) any payment of principal or interest on subordinated debt without prior regulatory approval and regulators must prohibit a critically undercapitalized institution from taking certain other actions without prior approval, including (1) entering into any material transaction other than in the usual course of business, including investment expansion, acquisition, sale of assets or other similar actions; (2) extending credit for any highly leveraged transaction; (3) amending articles or bylaws unless required to do so to comply with any law, regulation or order; (4) making any material change in accounting methods; (5) engaging in certain affiliate transactions; (6) paying excessive compensation or bonuses; and (7) paying interest on new or renewed liabilities at rates which would increase the weighted average costs of funds beyond prevailing rates in the institution’s normal market areas.

Effective January 1, 2015, the prompt corrective action regulations are amended to the extent described above in “*Basel III – New Capital and Prompt Corrective Action Regulations.*”

### **Additional Regulations**

Under the FDICIA, the federal financial institution agencies have adopted regulations which require institutions to establish and maintain comprehensive written real estate policies which address certain lending considerations, including loan-to-value limits, loan administrative policies, portfolio diversification standards, and documentation, approval and reporting requirements. The FDICIA further generally prohibits an insured state bank from engaging as a principal in any activity that is impermissible for a national bank, absent FDIC determination that the activity would not pose a significant risk to the Bank Insurance Fund, and that the bank is, and will continue to be, within applicable capital standards.

The Federal Financial Institution Examination Counsel (“FFIEC”) utilizes the Uniform Financial Institutions Rating System (“UFIRS”) commonly referred to as “CAMELS” to classify and evaluate the soundness of financial institutions. Bank examiners use the CAMELS measurements to evaluate capital adequacy, asset quality, management, earnings, liquidity and sensitivity to market risk. Effective January 1, 2005, bank holding companies such as the Company, were subject to evaluation and examination under a revised bank holding company rating system. The so-called BOPEC rating system implemented in 1979 was primarily focused on financial condition, consolidated capital and consolidated earnings. The rating system reflects the change toward analysis of risk management (as reflected in bank examination under the CAMELS measurements), in addition to financial factors and the potential impact of nondepository subsidiaries upon depository institution subsidiaries.

The federal financial institution agencies have established bases for analysis and standards for assessing a financial institution’s capital adequacy in conjunction with the risk-based capital guidelines including analysis of interest rate risk, concentrations of credit risk, risk posed by non-traditional activities, and factors affecting overall safety and soundness. The safety and soundness standards for insured financial institutions include analysis of (1) internal controls, information systems and internal audit systems; (2) loan documentation; (3) credit underwriting; (4) interest rate exposure; (5) asset growth; (6) compensation, fees and benefits; and (7) excessive compensation for executive officers, directors or principal shareholders which could lead to material financial loss. If an agency determines that an institution fails to meet any standard, the agency may require the financial institution to submit to the agency an acceptable plan to achieve compliance with the standard. If the agency requires submission of a compliance plan and the institution fails to timely submit an acceptable plan or to implement an accepted plan, the agency must require the institution to correct the deficiency. The agencies may elect to initiate enforcement action in certain cases rather than rely on an existing plan particularly where failure to meet one or more of the standards could threaten the safe and sound operation of the institution.

Community Reinvestment Act (“CRA”) regulations evaluate banks’ lending to low and moderate income individuals and businesses across a four-point scale from “outstanding” to “substantial noncompliance,” and are a factor in regulatory review of applications to merge, establish new branches or form bank holding companies. In addition, any bank rated in “substantial noncompliance” with the CRA regulations may be subject to enforcement proceedings. In its most recent exam for CRA compliance, American River Bank has a rating of “satisfactory.”

## Limitations on Dividends

The Company's ability to pay cash dividends is subject to restrictions set forth in the California General Corporation Law. Funds for payment of any cash dividends by the Company would be obtained from its investments as well as dividends and/or management fees from its subsidiaries. The payment of cash dividends and/or management fees by American River Bank is subject to restrictions set forth in the California Financial Code, as well as restrictions established by the FDIC. On July 27, 2009, it was announced that the Board of Directors had suspended the payment of cash dividends, until such time that it was prudent to reestablish the payment of cash dividends. The Company relies on distributions from the Bank in the form of cash dividends in order to pay cash dividends to our shareholders. See [Item 5](#), "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" for more information regarding cash dividends.

## Competition

### Competitive Data

*American River Bank.* At June 30, 2013, based on the most recent "Data Book Summary of Deposits in FDIC Insured Commercial and Savings Banks" report at that date, the competing commercial and savings banks had 196 offices in the cities of Fair Oaks, Rancho Cordova, Roseville and Sacramento, California, where American River Bank has its 5 Sacramento area offices, 59 offices in the cities of Healdsburg and Santa Rosa, California, where American River Bank has its 2 Sonoma County offices, and 3 offices in the cities of Jackson, Pioneer and Ione, California, where American River Bank has its 3 Amador County offices. Additionally, American River Bank competes with thrifts and, to a lesser extent, credit unions, finance companies and other financial service providers for deposit and loan customers.

Larger banks may have a competitive advantage because of higher lending limits and major advertising and marketing campaigns. They also perform services, such as trust services, international banking, discount brokerage and insurance services, which American River Bank is not authorized nor prepared to offer currently. American River Bank has made arrangements with its correspondent banks and with others to provide some of these services for its customers. For borrowers requiring loans in excess of American River Bank's legal lending limits, American River Bank has offered, and intends to offer in the future, such loans on a participating basis with its correspondent banks and with other community banks, retaining the portion of such loans which is within its lending limits. As of December 31, 2013, American River Bank's aggregate legal lending limits to a single borrower and such borrower's related parties were \$13,889,000 on an unsecured basis and \$23,149,000 on a fully secured basis based on capital and allowable reserves of \$92,595,000.

American River Bank's business is concentrated in its service area, which primarily encompasses Sacramento County, South Western Placer County, Sonoma County, and Amador County. The economy of American River Bank's service area is dependent upon government, manufacturing, tourism, retail sales, agriculture, population growth and smaller service oriented businesses.

Based upon the most recent "Data Book Summary of Deposits in FDIC Insured Commercial and Savings Banks" report dated June 30, 2013, there were 233 operating commercial and savings bank offices in Sacramento County with total deposits of \$23,210,056,000. This was an increase of \$1,318,443,000 compared to the June 30, 2012 balances. American River Bank held a total of \$243,289,000 in deposits, representing approximately 1.1% of total commercial and savings banks deposits in Sacramento County as of June 30, 2013.

Based upon the most recent "Data Book Summary of Deposits in FDIC Insured Commercial and Savings Banks" report dated June 30, 2013, there were 113 operating commercial and savings bank offices in Placer County with total deposits of \$9,636,035,000. This was an increase of \$1,910,683,000 over the June 30, 2012 balances. American River

Bank held a total of \$57,237,000 in deposits, representing approximately 0.6% of total commercial and savings banks deposits in Placer County as of June 30, 2013.

Based upon the most recent “Data Book Summary of Deposits in FDIC Insured Commercial and Savings Banks” report dated June 30, 2013, there were 129 operating commercial and savings bank offices in Sonoma County with total deposits of \$10,412,171,000. This was an increase of \$419,266,000 compared to the June 30, 2012 balances. American River Bank held a total of \$76,537,000 in deposits, representing approximately 0.7% of total commercial and savings banks deposits in Sonoma County as of June 30, 2013.

Based upon the most recent “Data Book Summary of Deposits in FDIC Insured Commercial and Savings Banks” report dated June 30, 2013, there were 13 operating commercial and savings bank offices in Amador County with total deposits of \$616,767,000. This was an increase of \$15,304,000 compared to the June 30, 2012 balances. American River Bank held a total of \$91,074,000 in deposits, representing approximately 14.8% of total commercial and savings bank deposits in Amador County as of June 30, 2013.

### **FDIC Insurance**

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the “EESA”) was signed into law. The EESA temporarily raised the limit on federal deposit insurance coverage provided by the FDIC from \$100,000 to \$250,000 per depositor. On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) into law, which, in part, permanently raises the current standard maximum deposit insurance amount per depositor to \$250,000.

On November 9, 2010, the FDIC issued a final rule implementing section 343 of the Dodd-Frank Act that provided for unlimited insurance coverage of noninterest-bearing transaction accounts. Beginning December 31, 2010, through December 31, 2012, all noninterest-bearing transaction accounts were fully insured, regardless of the balance of the account, at all FDIC-insured institutions. The unlimited insurance coverage was available to all depositors, including consumers, businesses, and government entities. This unlimited insurance coverage was separate from, and in addition to, the insurance coverage provided to a depositor’s other deposit accounts held at an FDIC-insured institution. This unlimited insurance coverage was not extended and terminated on December 31, 2012. The \$250,000 maximum deposit insurance amount per depositor remains in effect.

On December 16, 2008, the FDIC approved an earlier proposed seven basis point rate increase for the first quarter 2009 assessment period effective January 1, 2009 as part of the Deposit Insurance Fund (“DIF”) restoration plan to achieve a minimum Designated Reserve Ratio (“DRR”) of 1.15 percent within five years. In addition, the FDIC adopted a final rule revising its risk-based assessment system, effective April 1, 2009. The changes to the assessment system involved adjustments to the risk-based calculation of an institution’s unsecured debt, secured liabilities and brokered deposits. The revisions effectively resulted in a range of possible assessments under the risk-based system of 7 to 77.5 basis points. Depending on any future losses that the FDIC DIF may suffer due to failed institutions, additional significant premium increases might occur in order to replenish the DIF. The FDIC also imposed a special assessment of 5 basis points on all insured institutions. This emergency assessment was calculated based on the insured institution’s assets at June 30, 2009 and paid on September 30, 2009. Based on our June 30, 2009 assets subject to the FDIC assessment, the Bank was assessed approximately \$253,000 for the special assessment. On November 12, 2009, the FDIC announced a final rule to require most banks to prepay their estimated quarterly risk-based assessments for 2010, 2011 and 2012. This prepaid amount for the Bank was \$3,886,000. In June 2013, based upon the final risk-based assessments for 2010, 2011 and 2012, the Company received a refund of \$1,465,000 from the FDIC of the unused amount of the estimated prepaid quarterly risk-based assessments.

The Dodd-Frank Act signed into law on July 21, 2010 also established a minimum DRR of 1.35 percent of estimated insured deposits. The Act also mandates that the FDIC adopt a restoration plan should the DIF balance fall below 1.35 percent and provides for dividends to financial institutions should the DIF balance exceed 1.50 percent. On February 7, 2011, the FDIC adopted a final rule which redefines the deposit insurance assessment base as required by the Dodd-Frank Act; makes changes to insurance premium assessment rates; implements DIF dividend provisions;

and revises the risk-based assessment system for large insured depository institutions (i.e., those institutions with at least \$10 billion in total assets). In December 2010, the FDIC increased the DRR of the DIF to 2.0 percent effective January 1, 2011. In December 2010, the FDIC increased the DRR of the DIF to 2.0 percent effective January 1, 2011, which has remained in effect and was reaffirmed as the designated reserve ratio for 2014 by order of the FDIC on October 8, 2013.

It is uncertain what effect the implementation of the changes to the insurance assessments will have upon the Company; however, continued deterioration or lack of improvement in the economic conditions impacting financial institutions may necessitate further increases in premium assessments to maintain the DIF which could adversely impact the Company's earnings.

## General Competitive Factors

In order to compete with the major financial institutions in its primary service areas, American River Bank uses to the fullest extent possible the flexibility which is accorded by their community bank status. This includes an emphasis on specialized services, local promotional activity, and personal contacts by their respective officers, directors and employees. American River Bank also seeks to provide special services and programs for individuals in their primary service area who are employed in the agricultural, professional and business fields, such as loans for equipment, furniture, tools of the trade or expansion of practices or businesses. In the event there are customers whose loan demands exceed their respective lending limits, they seek to arrange for such loans on a participation basis with other financial institutions. Furthermore, American River Bank also assists those customers requiring services not offered by either bank to obtain such services from correspondent banks.

Commercial banks compete with savings and loan associations, credit unions, other financial institutions and other entities for funds. For instance, yields on corporate and government debt securities and other commercial paper affect the ability of commercial banks to attract and hold deposits. Commercial banks also compete for loans with savings and loan associations, credit unions, consumer finance companies, mortgage companies and other lending institutions.

Banking is a business that depends on interest rate differentials. In general, the difference between the interest rate paid by a bank to obtain their deposits and other borrowings and the interest rate received by a bank on loans extended to customers and on securities held in a bank's portfolio comprise the major portion of a bank's revenues.

The interest rate differentials of a bank, and therefore their revenues, are affected not only by general economic conditions, both domestic and foreign, but also by the monetary and fiscal policies of the United States as set by statutes and as implemented by federal agencies, particularly the Federal Reserve Board. The Federal Reserve Board can and does implement national monetary policy, such as seeking to curb inflation and combat recession, by its open market operations in United States government securities, adjustments in the amount of interest free reserves that banks and other financial institutions are required to maintain, and adjustments to the discount rates applicable to borrowing by banks from the Federal Reserve Board. These activities influence the growth of bank loans, investments and deposits and also affect interest rates charged on loans and paid on deposits. The nature and timing of any future changes in monetary policies and their impact on American River Bank is not predictable.

## Impact of Certain Legislation and Regulation

*Interstate Banking.* Since 1996, California law implementing certain provisions of prior federal law has (1) permitted interstate merger transactions; (2) prohibited interstate branching through the acquisition of a branch business unit located in California without acquisition of the whole business unit of the California bank; and (3) prohibited interstate branching through de novo establishment of California branch offices. Initial entry into California by an out-of-state institution must be accomplished by acquisition of or merger with an existing whole bank which has been in existence for at least five years. The Dodd-Frank Act signed into law by President Obama on July 21, 2010, includes provisions authorizing national and state banks to establish branch offices in other states to the same extent as a bank chartered by that state would be permitted to branch. Previously, banks could only establish branch offices in other states if the host state expressly permitted out-of-state banks to establish branch offices in that state. Accordingly, banks may be able to enter new markets more freely.

*Gramm-Leach-Bliley Act.* In 1999, the Gramm-Leach-Bliley Act (the "GLB Act") was signed into law. The GLB Act eliminated most of the remaining depression-era "firewalls" between banks, securities firms and insurance companies which were established by The Banking Act of 1933, also known as the Glass-Steagall Act ("Glass-Steagall"). Glass-Steagall sought to insulate banks as depository institutions from the perceived risks of securities dealing and underwriting, and related activities. The GLB Act permitted bank holding companies that could qualify as "financial holding companies" to acquire securities firms or create them as subsidiaries, and securities firms could acquire banks



or start banking activities through a financial holding company. Prior to the GLB Act, banks were also (with minor exceptions) prohibited from engaging in insurance activities or affiliating with insurers. The GLB Act removed these restrictions and substantially eliminated the prohibitions under the Bank Holding Company Act on affiliations between banks and insurance companies. Consequently, the common ownership of banks, securities firms and insurance firms was possible, in addition to the conduct of commercial banking, merchant banking, investment management, securities underwriting and insurance within a single financial institution using a “financial holding company” structure authorized by the GLB Act.

A bank holding company could qualify as a financial holding company if (i) its banking subsidiaries are “well capitalized” and “well managed” and (ii) it files with the Board of Governors a certification to such effect and a declaration that it elects to become a financial holding company. The Bank Holding Company Act was amended to permit financial holding companies to engage in activities, and acquire companies engaged in activities, that are financial in nature or incidental to such financial activities. Financial holding companies were also permitted to engage in activities that were complementary to financial activities if the Board of Governors determined that the activity did not pose a substantial risk to the safety or soundness of depository institutions or the financial system in general. These standards expanded upon the list of activities “closely related to banking” which have defined the permissible activities of bank holding companies under the Bank Holding Company Act. Neither Company nor American River Bank has determined whether or when to seek to acquire and exercise powers or activities under the GLB Act.

*Volcker Rule.* On December 10, 2013, the federal banking agencies jointly issued a final rule implementing the so-called “Volcker Rule” (set forth in Section 619 of the Dodd-Frank Act). The Volcker Rule prohibits depository institutions, companies that control such institutions, bank holding companies, and the affiliates and subsidiaries of such banking entities, from engaging as principal for the trading account of the banking entity in any purchase or sale of one or more covered financial instruments (so-called “proprietary trading”) and imposes limitations upon retaining ownership interests in, sponsoring, investing in and transacting with certain investment funds, including hedge funds and private equity funds. Certain activities involving underwriting, risk mitigation hedging, and transactions on behalf of customers as a fiduciary or riskless principal are not prohibited proprietary trading, including purchases and sales of financial instruments which are either obligations of or issued or guaranteed by (i) the United States or agencies thereof; (ii) a State or political subdivision including municipal securities; or (iii) the FDIC. Notwithstanding these permissible activities, no such activities are permitted if they would (i) involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties; (ii) result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or (iii) pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States. The effective date of the final rule is delayed to July 21, 2015 in order to provide a transitional period for banking entities to conform their activities and policies to the final rule. Neither the Company nor American River Bank engages in activities prohibited by the Volcker Rule and we do not expect the Volcker Rule to have a material impact upon the Company or American River Bank.

*Patriot Act.* On October 26, 2001, President Bush signed the USA Patriot Act (the “Patriot Act”), which includes provisions pertaining to domestic security, surveillance procedures, border protection, and terrorism laws to be administered by the Secretary of the Treasury. Title III of the Patriot Act entitled, “International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001” includes amendments to the Bank Secrecy Act which expand the responsibilities of financial institutions in regard to anti-money laundering activities with particular emphasis upon international money laundering and terrorism financing activities through designated correspondent and private banking accounts.

Effective December 25, 2001, Section 313(a) of the Patriot Act prohibits any insured financial institution such as American River Bank, from providing correspondent accounts to foreign banks which do not have a physical presence in any country (designated as “shell banks”), subject to certain exceptions for regulated affiliates of foreign banks. Section 313(a) also requires financial institutions to take reasonable steps to ensure that foreign bank correspondent accounts are not being used to indirectly provide banking services to foreign shell banks, and Section 319(b) requires financial institutions to maintain records of the owners and agent for service of process of any such foreign banks with whom correspondent accounts have been established.

Effective July 23, 2002, Section 312 of the Patriot Act created a requirement for special due diligence for correspondent accounts and private banking accounts. Under Section 312, each financial institution that establishes, maintains, administers, or manages a private banking account or a correspondent account in the United States for a

non-United States person, including a foreign individual visiting the United States, or a representative of a non-United States person shall establish appropriate, specific, and, where necessary, enhanced, due diligence policies, procedures, and controls that are reasonably designed to detect and record instances of money laundering through those accounts.

The Patriot Act contains various provisions in addition to Sections 313(a) and 312 that affect the operations of financial institutions by encouraging cooperation among financial institutions, regulatory authorities and law enforcement authorities with respect to individuals, entities and organizations engaged in, or reasonably suspected of engaging in, terrorist acts or money laundering activities. The Company and American River Bank are not currently aware of any account relationships between American River Bank and any foreign bank or other person or entity as described above under Sections 313(a) or 312 of the Patriot Act.

Certain surveillance provisions of the Patriot Act were scheduled to expire, but were extended by President Bush. On May 26, 2011, President Obama signed a further four year extension of the surveillance provisions.

The effects which the Patriot Act and any amendments to the Patriot Act or additional legislation enacted by Congress may have upon financial institutions is uncertain; however, such legislation could increase compliance costs and thereby potentially may have an adverse effect upon the Company's results of operations.

*Sarbanes-Oxley Act.* On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the "Act") which responded to issues in corporate governance and accountability. Among other matters, key provisions of the Act and rules promulgated by the SEC pursuant to the Act include the following:

Expanded oversight of the accounting profession by creating a new independent public company oversight board to be monitored by the SEC.

Revised rules on auditor independence to restrict the nature of non-audit services provided to audit clients and to require such services to be pre-approved by the audit committee.

Improved corporate responsibility through mandatory listing standards relating to audit committees, certifications of periodic reports by the CEO and CFO and making issuer interference with an audit a crime.

Enhanced financial disclosures, including periodic reviews for largest issuers and real time disclosure of material company information.

Enhanced criminal penalties for a broad array of white collar crimes and increases in the statute of limitations for securities fraud lawsuits.

Disclosure of whether a company has adopted a code of ethics that applies to the company's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, and disclosure of any amendments or waivers to such code of ethics.

Disclosure of whether a company's audit committee of its board of directors has a member of the audit committee who qualifies as an "audit committee financial expert."

A prohibition on insider trading during pension plan black-out periods.

Disclosure of off-balance sheet transactions.

A prohibition on personal loans to directors and officers.

Conditions on the use of non-GAAP (generally accepted accounting principles) financial measures.

Standards on professional conduct for attorneys requiring attorneys having an attorney-client relationship with a company, among other matters, to report "up the ladder" to the audit committee, another board committee or the entire

board of directors certain material violations.

Expedited filing requirements for Form 4 reports of changes in beneficial ownership of securities reducing the filing deadline to within 2 business days of the date a transaction triggers an obligation to report.

Accelerated filing requirements for Forms 10-K and 10-Q by public companies which qualify as “accelerated filers” to a phased-in reduction of the filing deadline for Form 10-K reports and Form 10-Q reports.

Disclosure concerning website access to reports on Forms 10-K, 10-Q and 8-K, and any amendments to those reports, by “accelerated filers” as soon as reasonably practicable after such reports and material are filed with or furnished to the SEC.

Rules requiring national securities exchanges and national securities associations to prohibit the listing of any security whose issuer does not meet audit committee standards established pursuant to the Act.

The requirement to report on internal controls over financial reporting in accordance with Section 404 of the Act. The Company's securities are listed on the Nasdaq Global Select Market. Consequently, in addition to the rules promulgated by the SEC pursuant to the Act, the Company must also comply with the listing standards applicable to Nasdaq listed companies. The Nasdaq listing standards applicable to the Company include standards related to (i) director independence, (ii) executive session meetings of the board, (iii) requirements for audit, nominating and compensation committee charters, membership qualifications and procedures, (iv) shareholder approval of equity compensation arrangements, and (v) code of conduct requirements that comply with the code of ethics under the Act.

The effect of the Act upon the Company is uncertain; however, the Company has incurred and it is anticipated that it will continue to incur increased costs to comply with the Act and the rules and regulations promulgated pursuant to the Act by the SEC, Nasdaq and other regulatory agencies having jurisdiction over the Company or the issuance and listing of its securities. The Company does not currently anticipate, however, that compliance with the Act and such rules and regulations will have a material adverse effect upon its financial position or results of its operations or its cash flows.

*Corporate Disclosure Act.* Effective January 1, 2003, the California Corporate Disclosure Act (the "CCD Act") required publicly traded corporations incorporated or qualified to do business in California to disclose information about their past history, auditors, directors and officers. Effective September 28, 2004, the CCD Act, as currently in effect and codified at California Corporations Code Section 1502.1, requires the Company to file with the California Secretary of State and disclose within 150 days after the end of its fiscal year certain information including the following:

The name of the a company's independent auditor and a description of services, if any, performed for a company during the previous two fiscal years and the period from the end of the most recent fiscal year to the date of filing;

The annual compensation paid to each director and the five most highly compensated non-director executive officers (including the CEO) during the most recent fiscal year, including all plan and non-plan compensation for all services rendered to a company as specified in Item 402 of Regulation S-K such as grants, awards or issuance of stock, stock options and similar equity-based compensation;

A description of any loans made to a director at a "preferential" loan rate during the company's two most recent fiscal years, including the amount and terms of the loans;

Whether any bankruptcy was filed by a company or any of its directors or executive officers within the previous 10 years;

Whether any director or executive officer of a company has been convicted of fraud during the previous 10 years; and

A description of any material pending legal proceedings other than ordinary routine litigation as specified in Item 103 of Regulation S-K and a description of such litigation where the company was found legally liable by a final judgment or order.

The Company does not currently anticipate that compliance with the CCD Act will have a material adverse effect upon its financial position or results of its operations or its cash flows.

*Fair and Accurate Credit Transactions Act.* The Board of Governors, the FDIC, the other federal financial institution regulatory agencies, and the Federal Trade Commission issued a joint press release on October 31, 2007 and final rules and guidelines effective January 1, 2008, subject to mandatory compliance as of November 1, 2008, implementing sections 114 and 315 of the Fair and Accurate Credit Transactions Act of 2003 to require financial institutions and other creditors to develop and implement a written identity theft prevention program. The program must include reasonable policies and procedures for detecting, preventing, and mitigating identity theft in connection with certain new and existing covered accounts. Covered accounts are defined as (i) an account primarily for personal, family, or household purposes (i.e., consumer accounts), or (ii) any other account for which there is a reasonably foreseeable risk to customers or the safety and soundness of the financial institution or creditor from identity theft. The program must be appropriate to the size and complexity of the financial institution or creditor and the nature and scope of its activities and should be designed to:

identify relevant patterns, practices, and specific forms of activity that are “red flags” of possible identity theft and incorporate those red flags into the program;

detect the occurrence of red flags incorporated into the program;

respond appropriately to any red flags that are detected to prevent and mitigate identity theft; and

ensure that the program is updated periodically to reflect changes in risks to customers or to the safety and soundness of the financial institution or creditor from identity theft.

The regulations include guidelines that each financial institution must consider and, to the extent appropriate, include in its program and steps that must be taken to administer the program including (i) obtaining approval of the program by the board of directors or a committee of the board, (ii) ensuring oversight of the development, implementation and administration of the program, (iii) training staff, and (iv) overseeing service provider arrangements. The guidelines contemplate that existing fraud prevention procedures may be incorporated into the program.

### **Legislation to Stabilize Financial Markets**

In response to global credit and liquidity issues involving a number of financial institutions, the United States government, particularly the United States Department of the Treasury (the “U.S. Treasury”) and the federal financial institution regulatory agencies, have taken a variety of extraordinary measures designed to restore confidence in the financial markets and to strengthen financial institutions, including capital injections, guarantees of bank liabilities and the acquisition of illiquid assets from banks. Below is a description of various legislation intended to stabilize the United States financial markets which directly or indirectly may affect us.

*Emergency Economic Stabilization Act.* On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the “EESA”) was signed into law. Pursuant to the EESA, the U.S. Treasury was granted the authority to take a range of actions for the purpose of stabilizing and providing liquidity to the U.S. financial markets and has implemented several programs, including the purchase by the U.S. Treasury of certain troubled assets from financial institutions under the Troubled Asset Relief Program” (the “TARP”) and the direct purchase by the U.S. Treasury of equity securities of financial institutions under the Capital Purchase Program (the “CPP”). The EESA also temporarily raised the limit on federal deposit insurance coverage provided by the FDIC from \$100,000 to \$250,000 per depositor.

*Capital Purchase Program.* On October 24, 2008, the U.S. Treasury announced plans to direct \$250 billion of the TARP funding into the CPP to acquire preferred stock investments in bank holding companies and banks with the capital acquired through such investments accorded Tier 1 capital treatment. Bank holding companies and banks eligible to participate as a Qualifying Financial Institution (“QFI”) in the CPP were required to enter into agreements with the U.S. Treasury containing various standard terms and conditions. The Company did not participate in the CPP and instead raised \$25.3 million (in gross proceeds) in a public offering in December 2009 to augment capital.

*Temporary Liquidity Guarantee Program.* Among other programs and actions taken by the U.S. Treasury and other regulatory agencies, the FDIC implemented the Temporary Liquidity Guarantee Program (the “TLGP”) to strengthen confidence and encourage liquidity in the financial system. The TLGP was comprised of the Debt Guarantee Program (the “DGP”) and the Transaction Account Guarantee Program (the “TAGP”). The DGP guaranteed all newly issued senior unsecured debt (e.g., promissory notes, unsubordinated unsecured notes and commercial paper) up to prescribed limits issued by participating entities beginning on October 14, 2008 and continuing through April 30, 2010. For eligible debt issued by that date, the FDIC provided the guarantee coverage until the earlier of the maturity date of the debt or June 30, 2012. The TAGP offered full guarantee for noninterest-bearing transaction accounts held at FDIC-insured depository institutions. The unlimited deposit coverage was voluntary for eligible institutions and was in addition to the \$250,000 FDIC deposit insurance per account that was included as part of the EESA. In addition to the risk-based deposit insurance premium paid on deposits, TAGP participants were assessed, on a quarterly basis, an annualized 25 basis points fee on balances in noninterest-bearing transaction accounts that exceeded the existing deposit insurance limit of \$250,000. The TAGP coverage became effective on October 14, 2008 and terminated on December 31, 2010 for all participating institutions. American River Bank opted to participate in the TAGP.



On November 9, 2010, the FDIC issued a final rule implementing section 343 of the Dodd-Frank Act that made permanent the \$250,000 deposit insurance limit per depositor and provided unlimited insurance coverage for noninterest-bearing transaction accounts. From December 31, 2010, through December 31, 2012, all noninterest-bearing transaction accounts were fully insured, regardless of the balance of the account, at all FDIC-insured institutions. The unlimited insurance coverage was available to all depositors, including consumers, businesses, and government entities. This unlimited insurance coverage was separate from, and in addition to, the insurance coverage provided to a depositor's other deposit accounts held at an FDIC-insured institution. This unlimited insurance coverage was not extended and terminated on December 31, 2012. The \$250,000 maximum deposit insurance amount per depositor remains in effect.

*Financial Stability Plan.* On February 10, 2009, the U.S. Treasury announced a Financial Stability Plan (the "FSP") as a comprehensive approach to strengthening the financial system and credit crisis. The Plan included a Capital Assistance Program (the "CAP") intended to serve as a bridge to raising private capital and to ensure sufficient capital to preserve or increase lending in a worse-than-expected economic deterioration. Eligibility to participate in the CAP was consistent with the criteria for QFI's under the CPP. Eligible institutions with consolidated assets in excess of \$100 billion were able to obtain capital under the CAP, subject to a supervisory review process and comprehensive stress test assessment of the losses that could occur over a two year period in the future across a range of economic scenarios, including conditions more severe than anticipated or as typically used in capital planning processes. Eligible institutions with consolidated assets below \$100 billion were able to obtain capital under the CAP after a supervisory review. As announced, the CAP included issuance of a convertible preferred security to the U.S. Treasury at a discount to the participating institution's stock price as of February 9, 2009, subject to a dividend to be determined. The security instrument was designed to incentivize institutions to replace the CAP capital with private capital or redeem it. Institutions participating in the CPP under TARP might also be permitted to exchange their CPP preferred stock for the convertible preferred CAP security. The Company did not participate in the CAP.

*American Recovery and Reinvestment Act.* On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (the "ARRA") was signed into law. Section 7001 of the ARRA amended Section 111 of the EESA in its entirety. While the U.S. Treasury was required to promulgate regulations to implement the restrictions and standards set forth in Section 7001, the ARRA, among other things, significantly expands the executive compensation restrictions previously imposed by the EESA. Such restrictions apply to any entity that participated in the CPP under TARP. Since the Company determined not to participate in the CPP, the executive compensation restrictions and standards set forth in Section 7001 of the ARRA are not applicable to the Company.

*Term Asset-Backed Securities Loan Facility.* On March 3, 2009, the U.S. Treasury and the Board of Governors announced the Term Asset-Backed Securities Loan Facility (the "TALF"). The TALF is one of the programs under the Financial Stability Plan announced by the U.S. Treasury on February 10, 2009. The TALF was intended to help stimulate the economy by increasing the availability of credit to businesses and consumers through loans facilitating securitization activities. The Federal Reserve Bank of New York ("FRBNY") could loan up to \$200 billion under the TALF to provide financing to investors, as support for purchases of certain highly-rated, asset-backed and commercial mortgage-backed securities consisting of certain loan asset classes including newly and recently originated consumer and small business loans and commercial mortgages. The FRBNY loaned approximately \$71 billion under the TALF and ceased making new loans on June 30, 2010. The Company did not participate in the TALF.

*The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.* On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). The Dodd-Frank Act is intended to restructure the regulation of the financial services sector by, among other things, (i) establishing a framework to identify systemic risks in the financial system implemented by a newly created Financial Stability Oversight Council and other federal banking agencies; (ii) expanding the resolution authority of the federal banking agencies over troubled financial institutions; (iii) authorizing changes to capital and liquidity requirements; (iv) changing deposit insurance assessments; and (v) enhancing regulatory supervision to improve the safety and

soundness of the financial services sector. The Dodd-Frank Act is expected to have a significant impact upon our business as its provisions are implemented over time. Below is a summary of certain provisions of the Dodd-Frank Act which, directly or indirectly, may affect us.

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*Changes to Capital Requirements.* The federal banking agencies are required to establish minimum leverage and risk-based capital requirements for banks and bank holding companies which will not be lower and could be higher than current regulatory capital and leverage standards for insured depository institutions. Under these requirements, trust preferred securities will be excluded from Tier 1 capital unless such securities were issued prior to May 19, 2010 by a bank holding company with less than \$15 billion in assets. The Dodd-Frank Act requires capital requirements to be counter cyclical so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction consistent with safety and soundness.

*Enhanced Regulatory Supervision.* The Dodd-Frank Act increases regulatory oversight, supervision and examination of banks, bank holding companies and their respective subsidiaries by the appropriate regulatory agency.

*Consumer Protection.* The Dodd-Frank Act creates the Consumer Financial Protection Bureau (“CFPB”) within the Federal Reserve System. The CFPB is responsible for establishing and implementing rules and regulations under various federal consumer protection laws governing certain consumer products and services. The CFPB has primary enforcement authority over large financial institutions with assets of \$10 billion or more, while smaller institutions will be subject to the CFPB’s rules and regulations through the enforcement authority of the federal banking agencies. States are permitted to adopt consumer protection laws and regulations that are more stringent than those laws and regulations adopted by the CFPB and state attorneys general are permitted to enforce consumer protection laws and regulations adopted by the CFPB.

*Deposit Insurance.* The Dodd-Frank Act permanently increases the deposit insurance limit for insured deposits to \$250,000 per depositor and extended unlimited deposit insurance to non-interest bearing transaction accounts through December 31, 2012. Other deposit insurance changes under the Dodd-Frank Act include (i) amendment of the assessment base used to calculate an insured depository institution’s deposit insurance premiums paid to the Deposit Insurance Fund (“DIF”) by elimination of deposits and substitution of average consolidated total assets less average tangible equity during the assessment period as the revised assessment base; (ii) increasing the minimum designated reserve ratio of the DIF from 1.15 percent to 1.35 percent of the estimated amount of total insured deposits; (iii) eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds; and (iv) repeal of the prohibition upon the payment of interest on demand deposits to be effective one year after the date of enactment of the Dodd-Frank Act. In December 2010, pursuant to the Dodd-Frank Act, the FDIC increased the reserve ratio of the DIF to 2.0 percent effective January 1, 2011.

*Transactions with Affiliates.* The Dodd-Frank Act enhances the requirements for certain transactions with affiliates under Section 23A and 23B of the Federal Reserve Act, including an expansion of the definition of “covered transactions” and increasing the amount of time for which collateral requirements regarding covered transactions must be maintained.

*Transactions with Insiders.* Insider transaction limitations are expanded through the strengthening of loan restrictions to insiders and the expansion of the types of transactions subject to the various limits, including derivative transactions, repurchase agreements, reverse repurchase agreements and securities lending or borrowing transactions. Restrictions are also placed on certain asset sales to and from an insider to an institution, including requirements that such sales be on market terms and, in certain circumstances, approved by the institution’s board of directors.

*Enhanced Lending Limitations.* The Dodd-Frank Act strengthens the existing limits on a depository institution’s credit exposure to include credit exposure arising from derivative transactions, repurchase agreements, and securities lending and borrowing transactions.

*Debit Card Interchange Fees.* The Dodd-Frank Act requires that the amount of any interchange fee charged by a debit card issuer with respect to a debit card transaction must be reasonable and proportional to the cost incurred by

the issuer. Within nine months of enactment of the Dodd-Frank Act, the Federal Reserve Board is required to establish standards for reasonable and proportional fees which may take into account the costs of preventing fraud. The restrictions on interchange fees, however, do not apply to banks that, together with their affiliates, have assets of less than \$10 billion.

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*Interstate Branching.* The Dodd-Frank Act authorizes national and state banks to establish branch offices in other states to the same extent as a bank chartered by that state would be permitted to branch. Previously, banks could only establish branch offices in other states if the host state expressly permitted out-of-state banks to establish branch offices in that state. Accordingly, banks may be able to enter new markets more freely.

*Charter Conversions.* Effective one year after enactment of the Dodd-Frank Act, depository institutions that are subject to a cease and desist order or certain other enforcement actions issued with respect to a significant supervisory matter are prohibited from changing their federal or state charters, except in accordance with certain notice, application and other procedures involving the applicable regulatory agencies.

*Compensation Practices.* The Dodd-Frank Act provides that the appropriate federal banking regulators must establish standards prohibiting as an unsafe and unsound practice any compensation plan of a bank holding company or other “covered financial institution” that provides an insider or other employee with “excessive compensation” or could lead to a material financial loss to such firm. In June 2010, prior to the enactment of the Dodd-Frank Act, the federal bank regulatory agencies jointly issued the *Interagency Guidance on Sound Incentive Compensation Policies* (“Guidance”), which requires that financial institutions establish metrics for measuring the risk to the financial institution of such loss from incentive compensation arrangements and implement policies to prohibit inappropriate risk taking that may lead to material financial loss to the institution. Together, the Dodd-Frank Act and the Guidance may impact our compensation policies and arrangements.

*Corporate Governance.* The Dodd-Frank Act will enhance corporate governance requirements to include (i) requiring publicly traded companies to give shareholders a non-binding vote on executive compensation at their first annual meeting taking place six months after the date of enactment and at least every three years thereafter and on so-called “golden parachute” payments in connection with approvals of mergers and acquisitions unless previously voted on by shareholders; (ii) authorizing the SEC to promulgate rules that would allow shareholders to nominate their own candidates for election as directors using a company’s proxy materials; (iii) directing the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of \$1.0 billion, regardless of whether or not the company is publicly traded; and (iv) authorizing the SEC to prohibit broker discretionary voting on the election of directors and on executive compensation matters.

Many of the requirements under the Dodd-Frank Act will be implemented over an extended period of time. Therefore, the nature and extent of regulations that will be issued by various regulatory agencies and the impact such regulations will have on the operations of financial institutions such as ours is unclear. Such regulations resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make necessary changes in order to comply with new statutory and regulatory requirements.

*Small Business Jobs Act of 2010/Small Business Lending Fund.* On September 27, 2010, President Obama signed into law the Small Business Jobs Act of 2010 (the “SBJ Act”), which, among other matters, authorized the U.S. Treasury to buy up to \$30 billion in preferred stock or subordinated debt issued by community banks (or their bank holding companies provided 90% of the funds received are downstreamed to the bank subsidiary) with assets less than \$10 billion pursuant to the Small Business Lending Fund (the “SBLF”) created under the SBJ Act. Funds received as capital investments qualify as Tier 1 capital. The SBLF investments are intended to increase the availability of credit for small businesses and thereby induce the creation of jobs in support of economic recovery.

The participating banks (or bank holding companies) pay an annual dividend on the preferred stock or subordinated debt purchased by the U.S. Treasury in an amount which ranges between 5% and 1% during the initial measurement period of approximately two years determined by reducing the dividend rate 1% for every 2.5% increase in the bank's small business lending up to a lending increase of 10%. The dividend rate is adjusted quarterly during the initial period. If a participant's lending activity does not increase in the initial period, the dividend rate increases thereafter to 7%. After 4.5 years, the dividend rate increases to 9%, until the SBLF funds are repaid. Participating banks in the SBLF were also permitted to use the SBLF funds they received to pay outstanding amounts due to the U.S. Treasury under the CPP and TARP. Many banks have repaid the U.S. Treasury CPP investment merely by transferring the investment to the SBLF.

On December 23, 2010, the federal banking agencies jointly issued guidance on underwriting standards for small business loans originated under the SBLF which require adherence to safe and sound credit standards and risk management processes. The Company did not participate in the SBLF.

### **Future Legislation and Regulation**

In addition to legislative changes, the various federal and state financial institution regulatory agencies frequently propose rules and regulations to implement and enforce already existing legislation. It cannot be predicted whether or in what form any such rules or regulations will be enacted or the effect that such regulations may have on American River Bankshares or American River Bank. However, in light of the current conditions in the U.S. financial markets and economy, Congress and regulators have increased their focus on the regulation of the financial services industry. The Company anticipates that additional regulations will likely increase the Company's expenses, which may adversely impact the Company's results of operations, financial condition, future prospects, profitability, and stock price.

### **Item 1A. Risk Factors.**

**The Company and its subsidiary, American River Bank, conduct business in an environment that includes certain risks described below which could have a material adverse effect on the Company's business, results of operations, financial condition, future prospects and stock price. You are also referred to the matters described under the heading "Cautionary Statements Regarding Forward-Looking Statements," in Part I, Item 1 and Part II, Item 7 of this report on Form 10-K for additional information regarding factors that may affect the Company's business.**

#### **We are subject to extensive regulation, which could adversely affect our business.**

Our operations are subject to extensive regulation by federal, state and local governmental authorities and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of our operations. We believe that we are in substantial compliance in all material respects with laws, rules and regulations applicable to the conduct of our business. Because our business is highly regulated, the laws, rules and regulations applicable to us are subject to regular modification and change. These laws, rules and regulations may be modified, or other new laws, rules or regulations, may be adopted in the future, which could make compliance much more difficult or expensive, or restrict our ability to originate, broker or sell loans, reduce service charge income on deposits, or further limit or restrict the amount of commissions, or interest or other charges earned on loans originated or sold by us or otherwise adversely affect our business, results of operations, financial condition, or future prospects. The Dodd-Frank Act, signed into law on July 21, 2010, has had and is expected to continue to have a broad impact on the financial services sector, including significant regulatory and compliance changes. Many of the Dodd-Frank Act requirements will be implemented over an extended period of time and due to the uncertainty associated with the manner in which they will be implemented by the various regulatory agencies, the full extent of the impact such

requirements will have on our operations is not clear. Changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage ratio requirements or otherwise adversely affect our business, results of operations, financial condition or future prospects.

**Difficult market conditions have adversely affected our business.**

Dramatic declines occurred in the housing market during the economic downturn resulting in falling home prices and a significant number of foreclosures. These circumstances along with unemployment and under-employment have negatively impacted the credit performance of our loan portfolio and resulted in significant write-downs of asset values. These asset write-downs have had a significant impact on the Company's financial results and ratios, including our net income, earnings per share, return on average equity and return on average assets. Our net income decreased from \$7,751,000 in 2008 to \$1,586,000 in 2009 and \$476,000 in 2010, then increased to \$2,504,000 in 2011, \$3,207,000 in 2012 and decreased slightly from 2012 to \$3,057,000 in 2013. Our earnings per share decreased from \$1.30 per share in 2008 to \$0.26 per share in 2009 and \$0.05 per share in 2010, then increased to \$0.25 per share in 2011 and \$0.34 per share in 2012 and 2013. Our return on average equity decreased from 12.39% in 2008 to 2.44% in 2009 and 0.53% in 2010, then increased to 2.74% in 2011, 3.42% in 2012 and decreased slightly from 2012 to 3.38% in 2013. Our return on average assets decreased from 1.32% in 2008 to 0.28% in 2009 and 0.08% in 2010, then increased to 0.43% in 2011, 0.55% in 2012, and 0.52% in 2013. While there were increases in our financial results and ratios in 2011, 2012 and 2013 compared to 2008 through 2010, the increases are below our historical averages and there is no guarantee that these increases will continue into the future, which could adversely affect our stock price. A significant decline in our stock price could result in substantial losses for individual shareholders.

**Worsening economic conditions could adversely affect our business.**

The economic conditions in the United States in general and within California and in our operating markets have not fully recovered from the recent economic downturn and may deteriorate. Unemployment nationwide and in California has increased significantly through the recent economic downturn and is anticipated to remain elevated for the foreseeable future. As of December 31, 2013, the unemployment rate nationwide was 6.7% compared to 7.9% at December 31, 2012, 8.5% at December 31, 2011, 9.4% at December 31, 2010, 9.9% at December 31, 2009, and 7.3% at December 31, 2008. As of December 31, 2013, the unemployment rate in California was 8.3% compared to 9.8% at December 31, 2012, 11.1% at December 31, 2011, 12.5% at December 31, 2010, 12.3% at December 31, 2009 and 8.7% at December 31, 2008. The unemployment rate in the Company's primary markets of Sacramento, Sonoma, and Amador Counties was 7.7%, 5.7% and 9.0%, respectively, at December 31, 2013 compared to 9.8%, 7.7% and 11.0%, respectively, at December 31, 2012, 10.9%, 8.9% and 12.7%, respectively, at December 31, 2011, 12.7%, 10.0% and 13.4%, respectively, at December 31, 2010, 12.2%, 10.3% and 12.5%, respectively, at December 31, 2009, and 8.7%, 7.0% and 9.3%, respectively, at December 31, 2008. These unemployment statistics may not reflect the full extent of unemployment conditions nationwide, in California and in the Company's primary operating markets due to the exclusion of statistics regarding the number of persons who are no longer seeking employment, among other statistical data. Availability of credit and consumer spending, real estate values, and consumer confidence have all been adversely affected. The credit, capital and liquidity problems that have confronted the U.S. financial system during the recent economic downturn have not been fully resolved despite massive government expenditures and legislative efforts to stabilize the U.S. financial system. These conditions may not be fully resolved in the foreseeable future.

The Bank conducts banking operations principally in Northern California. As a result, our financial condition, results of operations and cash flows are subject to changes in the economic conditions in Northern California. Our business results are dependent in large part upon the business activity, population, income levels, deposits and real estate activity in Northern California, and continued adverse economic conditions could have a material adverse effect upon us. In addition, California's budgetary and fiscal difficulties during the recent economic downturn resulted in a reduction of the number of California government employees. The businesses operating in California and, in particular in the City of Sacramento, depend on the relationships with these government employees, and reduced spending activity by these government employees could have a material impact on the success or failure of these businesses, some of which are current customers or could become future customers of the Bank.

The market in which the Company operates continues to see a slowdown in new loan volume as existing and potential new borrowers continue to pay down debt and delay expansion plans. This reduction in loan volume has had an adverse effect upon our net interest margin and profitability. The economic conditions in the United States in general



and in the State of California and within our operating markets may further deteriorate and such deterioration may materially and adversely affect our results of operations. A further deterioration in economic conditions locally, regionally or nationally could result in a further economic downturn in Northern California with the following consequences, any of which could further adversely affect our business:

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loan delinquencies and defaults may increase;

problem assets and foreclosures may increase;

demand for loans and other products and services may decline;

low cost or noninterest bearing deposits may decrease;

collateral for loans may decline in value, in turn reducing clients' borrowing power, and reducing the value of assets and collateral as sources of repayment of existing loans;

foreclosed assets may not be able to be sold;

volatile securities market conditions could adversely affect valuations of investment portfolio assets; and

reputational risk may increase due to public sentiment regarding the banking industry.

**Non-performing assets take significant time to resolve and adversely affect our results of operations and financial condition.**

At December 31, 2013, our non-performing loans and leases were 0.77% of total loans and leases compared to 2.12% of total loans and leases at December 31, 2012, 4.46% at December 31, 2011, 6.52% at December 31, 2010, 5.46% at December 31, 2009 and 1.49% at December 31, 2008. At December 31, 2013, our non-performing assets (which include foreclosed real estate and repossessed assets) to total assets were 1.60% compared to 2.97% at December 31, 2012, 3.73% at December 31, 2011, 4.36% at December 31, 2010, 3.95% at December 31, 2009, and 1.49% at December 31, 2008. The allowance for loan and lease losses as a percentage of non-performing loans and leases was 270.1% as of December 31, 2013 compared to 105.6% as of December 31, 2012, 52.5% as of December 31, 2011, 33.6% at December 31, 2010, 37.7% at December 31, 2009 and 94.8% at December 31, 2008. While these non-performing loans and leases and non-performing assets may have decreased in 2013, the resulting ratios are below our historical averages and there is no guarantee that these decreases will continue into the future, which could adversely affect our stock price. A significant decline in our stock price could result in substantial losses for individual shareholders.

Non-performing assets adversely affect our net income in various ways. We generally do not record interest income on non-performing loans or other real estate owned, thereby adversely affecting our income and increasing our loan administration costs. When we take collateral in foreclosures and similar proceedings, we are required to mark the related asset to the then fair market value of the collateral, which may ultimately result in a loss. An increase in the level of non-performing assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the ensuing risk profile, which could result in a request to reduce our level of non-performing assets and/or raise additional capital. When we reduce problem assets through loan sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral, or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, results of operations and financial condition. In addition, the resolution of non-performing assets requires significant commitments of time from management and our directors, which can be detrimental to the performance of their other responsibilities. We may experience increases in non-performing assets and the disposition of such non-performing assets may adversely affect our profitability.

**Tightening of credit markets and liquidity risk could adversely affect our business, financial condition and results of operations.**

A tightening of the credit markets or any inability to obtain adequate funds for asset growth at an acceptable cost could adversely affect our asset growth and liquidity position and, therefore, our earnings capability. In addition to core deposit growth, maturity of investment securities and loan and lease payments, we also rely on alternative funding sources including unsecured borrowing lines with correspondent banks, secured borrowing lines with the Federal Home Loan Bank of San Francisco and the Federal Reserve Bank of San Francisco, and public time certificates of deposits. Our ability to access these sources could be impaired by deterioration in our financial condition as well as factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations for the financial services industry or serious dislocation in the general credit markets. In the event such a disruption should occur, our ability to access these sources could be adversely affected, both as to price and availability, which would limit or potentially raise the cost of the funds available to us.

**We have a concentration risk in real estate related loans.**

At December 31, 2013, \$222.6 million, or 86.5% of our total loan and lease portfolio, consisted of real estate related loans. Of that amount, \$184.2 million, or 82.7%, consisted of commercial real estate, \$9.6 million, or 4.3% consisted of commercial and residential construction loans (including land acquisition and development loans) and \$28.8 million, or 13.0%, consisted of residential mortgages and residential multi-family real estate. Substantially all of our real property collateral is located in our operating markets in Northern California. The deteriorating economic conditions in California and in our operating markets during the recent economic downturn has contributed to an overall decline in commercial and residential real estate values. A continuing substantial decline in commercial and residential real estate values in our primary market areas could occur as a result of worsening economic conditions or other events including natural disasters such as earthquakes, fires, and floods. Such a decline in values could have an adverse impact on us by limiting repayment of defaulted loans through sale of commercial and residential real estate collateral and by a likely increase in the number of defaulted loans to the extent that the financial condition of our borrowers is adversely affected by such a decline in values.

At December 31, 2013, our residential construction loans (including land acquisition and development loans) were just \$4.8 million, or 1.9% of our total loans and leases, and these loans were comprised of 4.6% owner-occupied loans and 95.4% non-owner-occupied loans. Construction, land acquisition and development lending involves additional risks because funds are advanced on the security of the project, which is of uncertain value prior to its completion. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project and the effects of governmental regulation on real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. As a result, non-owner-occupied construction loans often involve the disbursement of substantial funds with repayment dependent, in part, on the completion of the project and the ability of the borrower to sell the property, rather than the ability of the borrower or the guarantor to repay the principal and interest. If our appraisal of the value of the completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project. If we are forced to foreclose on a project prior to or at completion due to a default, we may not be able to recover all of the unpaid balance and accrued interest related to the loan, as well as related foreclosure and holding costs. In addition, we may be required to fund additional amounts to complete the project and may have to hold the property for an unspecified period of time. The adverse effects of the foregoing matters upon our real estate portfolio could necessitate a material increase in the provision for loan and lease losses.

**Our allowance for loan and lease losses may not be adequate to cover actual losses.**

Like all financial institutions, the Bank maintains an allowance for loan and lease losses to provide for loan defaults and non-performance, but its allowance for loan and lease losses may not be adequate to cover actual loan and lease losses. In addition, future provisions for loan and lease losses could materially and adversely affect the Bank's and therefore our Company's operating results. The adequacy of the Bank's allowance for loan and lease losses is based on prior experience, as well as an evaluation of the risks in the current portfolio. The amount of realizable future losses is susceptible to changes in economic, operating and other conditions, including changes in the local and general California real estate market and operating environment, as well as interest rates, employment levels and other economic factors that may be beyond our control, and these losses may exceed current estimates.

Federal regulatory agencies, as an integral part of the examination process, review the Bank's loans and leases and allowance for loan and lease losses, as well as management's policies and procedures for determining the adequacy of the allowance for loan and lease losses. We believe that our allowance for loan and lease losses policies are effective and that our allowance for loan and lease losses is adequate to cover current probable incurred losses. However, the Bank may have to further increase the allowance for loan and lease losses as a result of the effects of deterioration of economic conditions nationally and in the operating markets in which the Bank conducts business and/or as a result of

changes in regulation or accounting methodologies.

**Our focus on lending to small to mid-sized community-based businesses may increase our credit risk.**

As of December 31, 2013, our largest outstanding commercial business loan and largest outstanding commercial real estate loan amounted to \$3.0 million and \$5.9 million, respectively. At such date, our commercial real estate loans amounted to \$184.2 million, or 71.6% of our total loan and lease portfolio, and our commercial business loans amounted to \$24.5 million, or 9.5% of our total loan and lease portfolio. Commercial real estate and commercial business loans generally are considered riskier than single-family residential loans because they have larger balances to a single borrower or group of related borrowers. Commercial real estate and commercial business loans involve risks because the borrowers' ability to repay the loans typically depends primarily on the successful operation of the businesses or the properties securing the loans. Most of the Bank's commercial real estate and commercial business loans are made to small business or middle market customers who may have a heightened vulnerability to economic conditions. Moreover, a portion of these loans have been made by us in recent years and the borrowers may not have experienced a complete business or economic cycle. Furthermore, the deterioration of our borrowers' businesses may hinder their ability to repay their loans with us, which could adversely affect our results of operations.

**Our business is subject to interest rate risk, and variations in interest rates may negatively affect our financial performance.**

Changes in the interest rate environment may reduce our net interest income. It is expected that we will continue to realize income from the differential or “margin” between the interest earned on loans, securities and other interest-earning assets, and interest paid on deposits, borrowings and other interest-bearing liabilities. Net interest margins are affected by the difference between the maturities and repricing characteristics of interest-earning assets and interest-bearing liabilities. In addition, loan volume and yields are affected by market interest rates on loans, and rising interest rates generally are associated with a lower volume of loan originations. We may be unable to minimize our interest rate risk. In addition, an increase in the general level of interest rates may adversely affect the ability of certain borrowers to pay the interest on and principal of their obligations. Accordingly, changes in levels of market interest rates could materially and adversely affect our net interest margin, asset quality, and loan origination volume.

**Governmental monetary policies and intervention to stabilize the U.S. financial system may affect our business and are beyond our control.**

The business of banking is affected significantly by the fiscal and monetary policies of the federal government and its agencies. Such policies are beyond our control. We are particularly affected by the policies established by the Federal Reserve Board in relation to the supply of money and credit in the United States. The instruments of monetary policy available to the Federal Reserve Board can be used in varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits, and this can and does have a material effect on our business.

Recent legislation including the Emergency Economic Stabilization Act of 2008 (the “EESA”), signed into law by President Bush on October 3, 2008, and the American Recovery and Reinvestment Act of 2009 (the “ARRA”), signed into law by President Obama on February 17, 2009, each included programs intended to help stabilize the U.S. financial system. However, the degree to which such legislation has helped to improve the credit, capital and liquidity problems confronting the financial system remains uncertain. The failure of the EESA or ARRA and other legislation intended to mitigate or eliminate such problems affecting the financial markets and a continuation or worsening of such conditions could limit our access to capital or sources of liquidity in amounts and at times necessary to conduct operations in compliance with applicable regulatory requirements.

**The Bank faces strong competition from banks, financial service companies and other companies that offer banking services, which could adversely affect our business.**

Increased competition in our market may result in reduced loans and deposits or the rates charged or paid on these instruments and adversely affect our net interest margin. Ultimately, we may not be able to compete successfully against current and future competitors. Many competitors offer similar banking services to those that are offered by the Bank in its service area. These competitors include national and super-regional banks, finance companies, investment banking and brokerage firms, credit unions, government-assisted farm credit programs, other community banks and technology-oriented financial institutions offering online services. In particular, the Bank’s competitors include several major financial companies whose greater resources may afford them a marketplace advantage by enabling them to maintain numerous banking locations and mount extensive promotional and advertising campaigns. Additionally, banks and other financial institutions with larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits than we do and are thereby better able to serve the credit needs of larger customers. Areas of competition include interest rates for loans and deposits, efforts to obtain loans and deposits, as well as the range and quality of products and services provided, including new technology-driven products and services. Technological innovation continues to contribute to greater competition in domestic and international financial services markets as technological advances, such as Internet-based banking services that cross traditional geographic bounds, enable more companies to provide financial services. If the Bank is unable to attract and retain banking customers, we may be unable to maintain our historical levels of loans and leases and deposits or

our net interest margin.

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**Our operations are dependent upon key personnel.**

Our future prospects are and will remain highly dependent on our directors, executive officers and other key personnel. Our success will, to some extent, depend on the continued service of our directors and continued employment of the executive officers, in addition to our ability to attract and retain experienced banking professionals to serve us and the Bank in other key positions. The unexpected loss of the services of any of these individuals could have a detrimental effect on our business.

**Technology implementation problems or computer system failures could adversely affect us.**

Our future growth prospects will be highly dependent on the ability of the Bank to implement changes in technology that affect the delivery of banking services such as the increased demand for computer access to bank accounts and the availability to perform banking transactions electronically. The Bank's ability to compete will depend upon its ability to continue to adapt technology on a timely and cost-effective basis to meet such demands. In addition, our business and operations and those of the Bank could be susceptible to adverse effects from computer failures, communication and energy disruption, and activities such as fraud of unethical individuals with the technological ability to cause disruptions or failures of the Bank's data processing system.

**Information security breaches or other technological difficulties could adversely affect us.**

We cannot be certain that the continued implementation of safeguards will eliminate the risk of vulnerability to technological difficulties or failures or ensure the absence of a breach of information security. The Bank will continue to rely on the services of various vendors who provide data processing and communication services to the banking industry. Nonetheless, if information security is compromised or other technology difficulties or failures occur at the Bank or with one of our vendors, information may be lost or misappropriated, services and operations may be interrupted and the Bank could be exposed to claims from its customers as a result.

**Our controls over financial reporting and related governance procedures may fail or be circumvented.**

Management regularly reviews and updates our internal control over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. We maintain controls and procedures to mitigate risks such as processing system failures or errors and customer or employee fraud, and we maintain insurance coverage for certain of these risks. Any system of controls and procedures, however well designed and operated, is based in part on certain assumptions and provides only reasonable, not absolute, certainty that the objectives of the system will be met. Events could occur which are not prevented or detected by our internal controls, are not insured against, or are in excess of our insurance limits. Any failure or circumvention of our controls and procedures, or failure to comply with regulations related to controls and procedures, could have an adverse effect on our business.

**We may not be successful in raising additional capital needed in the future.**

If additional capital is needed in the future as a result of losses, our business strategy or regulatory requirements, our efforts to raise such additional capital may be unsuccessful or shares sold in the future may be sold at prices or on terms that are not equal to or better than the current market price. The inability to raise additional capital when needed or at prices and terms acceptable to us could adversely affect our ability to implement our business strategies.

**The effects of legislation in response to credit conditions may adversely affect us.**

Legislation that has or may be passed at the federal level and/or by the State of California in response to conditions affecting credit markets could cause us to experience higher credit losses if such legislation reduces the amount that the Bank's borrowers are otherwise contractually required to pay under existing loan contracts. Such legislation could also result in the imposition of limitations upon the Bank's ability to foreclose on property or other collateral or make foreclosure less economically feasible. Such events could result in increased loan and lease losses and require a material increase in the allowance for loan and lease losses.





**The effects of changes to FDIC insurance coverage limits and assessments are uncertain and increased premiums may adversely affect us.**

FDIC insurance premium assessments are uncertain and increased premium assessments may adversely affect our earnings. The FDIC charges insured financial institutions premiums to maintain the Deposit Insurance Fund (“DIF”). Recent economic conditions have resulted and may continue to result in bank failures. In such event, the FDIC may take control of failed institutions and guarantee payment from the DIF up to the insured limit for deposits held at such failed institutions. Depending on any future losses that the DIF may suffer due to failed institutions, there may be additional premium increases in order to replenish the DIF.

The FDIC adopted a final rule revising its risk-based assessment system, effective April 1, 2009. The changes to the assessment system involved adjustments to the risk-based calculation of an institution’s unsecured debt, secured liabilities and brokered deposits. The revisions effectively resulted in a range of possible assessments under the risk-based system of 7 to 77.5 basis points. The FDIC also imposed a special assessment of 5 basis points on all insured institutions. This emergency assessment was calculated based on the insured institution’s assets at June 30, 2009 and paid on September 30, 2009. Based on our June 30, 2009 assets subject to the FDIC assessment, the Bank was assessed approximately \$253,000 for the special assessment. In addition, on November 12, 2009, the FDIC announced a final rule to require most banks to prepay their estimated quarterly risk-based assessments for 2010, 2011 and 2012. This prepaid amount for the Bank was \$3,886,000. In June 2013, based upon the final risk-based assessments for 2010, 2011 and 2012, the Company received a refund of \$1,465,000 from the FDIC of the unused amount of the estimated prepaid quarterly risk-based assessments.

On November 9, 2010, the FDIC issued a final rule implementing section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) that made permanent a \$250,000 deposit insurance limit per depositor and provided unlimited insurance coverage for noninterest-bearing transaction accounts. Beginning December 31, 2010, through December 31, 2012, all noninterest-bearing transaction accounts were fully insured, regardless of the balance of the account, at all FDIC-insured institutions. The unlimited insurance coverage was available to all depositors, including consumers, businesses, and government entities. This unlimited insurance coverage was separate from, and in addition to, the insurance coverage provided to a depositor’s other deposit accounts held at an FDIC-insured institution. This unlimited insurance coverage was not extended and terminated on December 31, 2012. The \$250,000 maximum deposit insurance amount per depositor remains in effect.

It is not clear how depositors will respond regarding the \$250,000 per depositor maximum deposit insurance coverage and the termination of unlimited insurance coverage for noninterest-bearing transaction accounts. Some depositors may reduce the amount of uninsured deposits held at the Bank and/or the level of insured deposits if concerns regarding bank failures persist, which could affect the level and composition of the Bank’s deposit portfolio and thereby directly impact the Bank’s funding costs and net interest margin. The Bank’s funding costs may also be adversely affected in the event that the activities of the Federal Reserve Board and the U.S. Treasury, intended to provide liquidity for the banking system and improvement in capital markets, are curtailed or unsuccessful. Such events could reduce liquidity in the markets, thereby increasing funding costs to the Bank or reducing the availability of funds to the Bank to finance its existing operations and thereby adversely affecting our results of operations.

In addition to permanently increasing the deposit insurance limit for insured deposits to \$250,000 per depositor and extending unlimited deposit insurance to non-interest bearing transaction accounts through December 31, 2012, the Dodd-Frank Act also made other deposit insurance changes which may affect our insurance premium assessments to include (i) amendment of the assessment base used to calculate an insured depository institution’s deposit insurance premiums paid to the DIF by elimination of deposits and substitution of average consolidated total assets less average tangible equity during the assessment period as the revised assessment base; (ii) increasing the minimum designated reserve ratio of the DIF from 1.15 percent to 1.35 percent of the estimated amount of total insured deposits; (iii) eliminating the requirement that the FDIC pay dividends to depository institutions when the reserve ratio exceeds certain thresholds; and (iv) repeal of the prohibition upon the payment of interest on demand deposits to be effective

one year after the date of enactment of the Dodd-Frank Act. In December 2010, pursuant to the Dodd-Frank Act, the FDIC increased the designated reserve ratio of the DIF to 2.0 percent effective January 1, 2011, which has remained in effect and was reaffirmed as the designated reserve ratio for 2014 by order of the FDIC on October 8, 2013. It is uncertain what effect these changes will have on our future insurance assessments and costs of operations, but any increases in premium assessments or further prepayment of assessments will adversely impact our earnings.

**In the future we may be required to recognize impairment with respect to investment securities, including the FHLB stock we hold.**

Our securities portfolio currently includes securities with unrecognized losses. We may continue to observe declines in the fair market value of these securities. We evaluate the securities portfolio for any other than temporary impairment each reporting period, as required by generally accepted accounting principles, and as of December 31, 2013, we did not recognize any securities as other than temporarily impaired. Future evaluations of the securities portfolio may require us to recognize an impairment charge with respect to these and other holdings. In addition, as a condition to membership in the Federal Home Loan Bank of San Francisco (the "FHLB"), we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB. At December 31, 2013, we held stock in the FHLB totaling \$3.2 million. The FHLB stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. The FHLB currently distributes cash dividends on its shares, however, past dividend paying practices are not a guarantee of future dividends. As of December 31, 2013, we did not recognize an impairment charge related to our FHLB stock holdings. Any future negative changes to the financial condition of the FHLB may require us to recognize an impairment charge with respect to such holdings.

**If the goodwill we have recorded in connection with our acquisition of Bank of Amador becomes impaired, it could have an adverse impact on our earnings and capital.**

At December 31, 2013, we had approximately \$16.3 million of goodwill on our balance sheet attributable to our merger with Bank of Amador in December 2004. In accordance with accounting principles generally accepted in the United States of America, our goodwill is not amortized but rather evaluated for impairment on an annual basis or more frequently if events or circumstances indicate that a potential impairment exists. Such evaluation is based on a variety of factors, including the quoted price of our common stock, market prices of the common stock of other banking organizations, common stock trading multiples, discounted cash flows, and data from comparable acquisitions. Future evaluations of goodwill may result in findings of impairment and write-downs, which could be material.

**The effects of terrorism and other events beyond our control may adversely affect our results of operations.**

The terrorist actions on September 11, 2001 and thereafter, as well as the military conflicts in Afghanistan and Iraq, have had significant adverse effects upon the United States economy. Whether terrorist activities in the future and the actions of the United States and its allies in combating terrorism on a worldwide basis will adversely impact us and the extent of such impact is uncertain. Similar events beyond our control including, but not limited to, financial and economic instability and governmental actions in response, natural disasters such as earthquakes, droughts, floods, fires, and similar adverse weather occurrences, disruption of power supplies and communications equipment such as telephones, cellular phones, computers, and other forms of electronic equipment or media, and widespread, adverse public health occurrences, may adversely affect our future results of operations by, among other things, disrupting the conduct of our operations and those of our customers, which could result in a reduction in the demand for loans and other products and services offered by the Bank, increase non-performing loans and the amounts reserved for loan and lease losses, or cause significant declines in our level of deposits.

**Future acquisitions and expansion activities may disrupt our business and adversely affect our operating results.**

We regularly evaluate potential acquisitions and expansion opportunities. To the extent that we grow through acquisitions, we cannot ensure that we will be able to adequately or profitably manage this growth. Acquiring other banks, branches or other assets, as well as other expansion activities, involves various risks including the risks of incorrectly assessing the credit quality of acquired assets, encountering greater than expected costs of incorporating acquired banks or branches into the Bank, executing cost savings measures, and being unable to profitably deploy funds in an acquisition.



**We may raise additional capital, which could have a dilutive effect on the existing holders of our common stock and adversely affect the market price of our common stock.**

In December 2009, the Company raised \$25.3 million (in gross proceeds) in a public offering of 4,048,000 shares of its common stock at \$6.25 per share. Our articles of incorporation, as amended, provide the authority to issue without further shareholder approval, 20,000,000 shares of common stock, no par value per share, of which 8,489,247 shares were issued and outstanding at December 31, 2013. Pursuant to the Company's 2010 Equity Incentive Plan and its 2000 Stock Option Plan, at December 31, 2013, employees and directors of the Company had outstanding options to purchase 277,923 shares of common stock. As of December 31, 2013, 1,432,312 shares of common stock remained available for awards under the 2010 Equity Incentive Plan.

We are not restricted from issuing additional shares of common stock or securities that are convertible into or exchangeable for, or that represent the right to receive, common stock. We frequently evaluate opportunities to access the capital markets taking into account our regulatory capital ratios, financial condition and other relevant considerations, and subject to market conditions, we may take further capital actions. Such actions could include, among other things, the issuance of additional shares of common stock in public or private transactions in order to further increase our capital levels above the requirements for a well-capitalized institution established by the federal bank regulatory agencies as well as other regulatory targets.

The issuance of any additional shares of common stock or securities convertible into or exchangeable for common stock or that represent the right to receive common stock, or the exercise of such securities including, without limitation, securities issued upon exercise of outstanding equity awards under our 2010 Equity Incentive Plan or outstanding options under our 2000 Stock Option Plan, could be substantially dilutive to shareholders of our common stock. Holders of our shares of common stock have no preemptive rights that entitle holders to purchase their pro rata share of any offering of shares of any class or series and, therefore, such sales or offerings could result in increased dilution to our shareholders. The market price of our common stock could decline as a result of sales of shares of our common stock or the perception that such sales could occur.

**The price of our common stock may fluctuate significantly, and this may make it difficult for shareholders to resell shares of common stock they own at times or at prices they find attractive.**

The stock market and, in particular, the market for financial institution stocks, has experienced significant volatility, which reached unprecedented levels during the recent economic downturn. In some cases, the markets have produced downward pressure on stock prices for certain issuers without regard to those issuers' underlying financial strength. As a result, the trading volume in our common stock may fluctuate more than usual and cause significant price variations to occur. This may make it difficult for shareholders to resell shares of common stock they own at times or at prices they find attractive. The low trading volume in our common shares on the NASDAQ Global Select Market means that our shares may have less liquidity than other publicly traded companies. We cannot ensure that the volume of trading in our common shares will be maintained or will increase in the future.

The trading price of the shares of our common stock will depend on many factors, which may change from time to time and which may be beyond our control, including, without limitation, our financial condition, performance, creditworthiness and prospects, future sales or offerings of our equity or equity related securities, and other factors identified above in the forward-looking statement discussion in Part I, Item 1 of this Annual Report on Form 10-K under the heading "Cautionary Statements Regarding Forward-Looking Statements" and below. These broad market fluctuations have adversely affected and may continue to adversely affect the market price of our common stock. Among the factors that could affect our stock price are:

actual or anticipated quarterly fluctuations in our operating results and financial condition;

changes in financial estimates or publication of research reports and recommendations by financial analysts or actions taken by rating agencies with respect to our common stock or those of other financial institutions;

failure to meet analysts' revenue or earnings estimates;

speculation in the press or investment community generally or relating to our reputation, our market area, our competitors or the financial services industry in general;

strategic actions by us or our competitors, such as acquisitions, restructurings, dispositions or financings;

actions by our current shareholders, including sales of common stock by existing shareholders and/or directors and executive officers;

fluctuations in the stock price and operating results of our competitors;

future sales of our equity, equity-related or debt securities;

changes in the frequency or amount of dividends or share repurchases;

proposed or adopted regulatory changes or developments;

anticipated or pending investigations, proceedings, or litigation that involves or affects us;

trading activities in our common stock, including short-selling;

domestic and international economic factors unrelated to our performance; and

general market conditions and, in particular, developments related to market conditions for the financial services industry.

A significant decline in our stock price could result in substantial losses for individual shareholders.

**We may be unable or choose not to pay cash dividends in the foreseeable future.**

Our ability to pay dividends on our common stock depends on a variety of factors. On July 27, 2009 we announced suspension of our quarterly dividends, as compared to our quarterly dividends of \$0.143 per share declared each quarter since the fourth quarter of 2007. The Company relies on distributions from the Bank in the form of cash dividends in order to pay cash dividends to our shareholders. Cash dividends may or may not be paid in the future since they are subject to regulatory restrictions and to evaluation by our Board of Directors of financial factors including, but not limited to, our earnings, financial condition and capital requirements.

**Anti-takeover provisions in our articles of incorporation and bylaws and California law could make a third party acquisition of us difficult.**

Our articles of incorporation and bylaws contain provisions that could make it more difficult for a third party to acquire us (even if doing so would be beneficial to our shareholders) and for holders of our common stock to receive any related takeover premium for their common stock. We are also subject to certain provisions of California law that would delay, deter or prevent a change in control of the Company. These provisions could limit the price that investors might be willing to pay in the future for shares of our common stock.

**Credit Downgrade Risk and European Market Risk.**

On August 5, 2011, Standard & Poor's downgraded the long-term credit rating of the U.S. from "AAA" to "AA+." This was the first downgrade of the U.S. credit rating in history. Prior to the action taken by S&P, Moody's placed the U.S. government under review for a possible credit ratings downgrade, but on August 2, 2011, Moody's confirmed the U.S. government's "AAA" credit rating while stating that the rating outlook was negative. Also, on August 2, 2011, Fitch affirmed its existing U.S. government credit rating, but stated that the rating was under review. Despite recent efforts and actions taken by the U.S. government to resolve budgetary problems that contributed to the downgrades, it is uncertain whether future additional downgrades may occur by such rating agencies.

The federal bank regulatory agencies jointly issued guidance on August 5, 2011 regarding the impact of the S&P downgrade upon risk-based capital treatment. The agencies advised banks that for risk-based capital purposes, the risk weights for Treasury securities and other securities issued or guaranteed by the U.S. government, government agencies, and government-sponsored entities will not change. The agencies also advised that treatment of Treasury



securities and other securities issued or guaranteed by the U.S. government, government agencies, and government-sponsored entities under other federal banking agency regulations, including, for example, the Federal Reserve Board's Regulation W, will also be unaffected.

Since 2011, political conflicts over raising the debt ceiling continued between the Obama administration and the U.S. Congress with the potential risk of another downgrade. On February 11 and 12, 2014, the House of Representatives and the U.S. Senate, respectively, each passed legislation approving an increase in the debt ceiling through March 2015, which President Obama signed on February 15, 2014. It remains uncertain whether these conflicts will arise again in 2015. If so and if not resolved, there is a risk of further downgrade of the U.S. "AAA" credit rating.

The effects of any future credit agency downgrade of the U.S. government's credit rating, or in the credit ratings of instruments issued, insured or guaranteed by related institutions, agencies or instrumentalities is uncertain, but such downgrades could result in risks to the Company and general economic conditions in the U.S. and in the Company's market areas, which we are unable to predict. In addition, there continues to be uncertainty about the effects upon the U.S. economy of the financial instability of several countries in the European Union and the risks of debt defaults posed by those countries. These economic circumstances could have a significant adverse effect on our business, results of operations and financial condition, which in turn could adversely affect our stock price.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

The Company and American River Bank lease nine and own two of their respective premises. The Company's headquarters is located at 3100 Zinfandel Drive, Suite 450, Rancho Cordova, California. The office space is located in a six-story office building. The lease term is seven (7) years and expires on July 31, 2017. The premises consist of approximately 12,218 square feet on the fourth floor of the building. The space is leased from MSCP Capital Center Investors, LLC, successor to One Capital Center.

American River Bank's main office is located at 1545 River Park Drive, Suite 107, Sacramento, California, in a modern, five-story building which has off-street parking for its clients. American River Bank leases premises in the building from Hines VAF II Sacramento Properties, L.P., the successor to Spieker Properties. The lease term is for one-hundred and twenty-seven (127) months and expires on February 28, 2021. The premises consist of 1,643 square feet on the ground floor.

American River Bank leases premises at 9750 Business Park Drive, Sacramento, California. The premises are leased from Bradshaw Plaza, Associates, Inc., which is owned in part by Charles D. Fite, a director of the Company. The lease term is ten (10) years and expires on November 30, 2016. The premises consist of 3,711 square feet on the ground floor.

American River Bank leases premises at 10123 Fair Oaks Boulevard, Fair Oaks, California. The premises are leased from Marjorie Wood-Taylor, Trustee of Marjorie Wood-Taylor Trust Established by Declaration of Trust dated September 2, 1992 under the provisions of a Trust Agreement dated September 2, 1992. Marjorie Wood-Taylor, is a former director of the Company. On May 14, 2009, the lease term was extended for five (5) years, beginning on March 1, 2009 and expiring on March 1, 2014. The premises consist of 2,380 square feet on the ground floor. On February 10, 2014, the Company filed with the Commission a Current Report on Form 8-K announcing a lease agreement dated February 6, 2014, between American River Bank and Gold River Village Associates, a California Limited Partnership, related to 11220 Gold River Express Drive, Gold River, California. The Company is in the process of preparing the Gold River location for occupancy and at that time will vacate the Fair Oaks location. The expected move is to occur on or before June 1, 2014. The Gold River location consists of 1,650 square feet on the ground floor and the lease term is one-hundred and twenty-six (126) months.

American River Bank leases premises at 2240 Douglas Boulevard, Roseville, California. The premises are leased from LUM YIP KEE, LIMITED (doing business as Twin Tree Land Company). The lease term is ten (10) years and expires on November 30, 2016. The premises consist of 3,790 square feet on the ground floor.

American River Bank leases premises at 520 Capitol Mall, Sacramento, California. The premises are leased from 520 Capitol Mall, Inc. The lease term is ten (10) years and expires on June 1, 2014. The premises consist of 4,010 square feet on the ground floor. On February 14, 2014, the Company filed with the Commission a Current Report on Form 8-K announcing a new lease agreement dated February 12, 2014, between American River Bank and 520 Capitol Mall, Inc. The new lease results in relocation from suite 100 to suite 200 in the same building. The Company is in the process of preparing suite 200 for occupancy and will vacate suite 100. The expected move is to occur on or before June 1, 2014. The new lease premises consist of 2,143 square feet on the second floor and the lease term is one-hundred and twenty-five (125) months.

American River Bank (formerly North Coast Bank, a division of American River Bank), owns premises at 412 Center Street, Healdsburg, California. The premises were purchased June 1, 1993. The purchase price for the land and building was \$343,849. The building consists of 2,620 square feet. The land consists of 10,835 square feet.

American River Bank (formerly North Coast Bank, a division of American River Bank), leases premises at 90 South E Street, Santa Rosa, California. The premises were subleased from Chicago Title Company through November 11, 2011 and now are leased from 90 E Street, LLC until January 31, 2019. The combined sublease and lease term is ten (10) years and expires on January 31, 2019. The premises consist of 3,600 square feet on the ground floor.

American River Bank (formerly Bank of Amador, a division of American River Bank), leases premises at 422 Sutter Street, Jackson, California. The premises are leased from the United States Postal Service. The most recent lease term was five (5) years and expired on May 31, 2011 and the premises consisted of 6,400 square feet on the ground floor and second floor. Effective June 1, 2011, the lease was extended for an additional five (5) years set to expire on May 31, 2016. The new lease term does not include the second floor and the new premises consist of approximately 3,600 square feet on the ground floor.

American River Bank (formerly Bank of Amador, a division of American River Bank), leases premises at 26395 Buckhorn Ridge Road, Pioneer, California. The premises are leased from Joseph T. Bellamy, Trustee of the Joseph T. Bellamy 2005 Trust. The lease term is ten (10) years and expires on October 31, 2017. The premises consist of 1,757 square feet of office space on the ground floor, an attached garage consisting of approximately 400 square feet and 1,223 feet of office space on the second floor.

American River Bank, owns premises at 66 Main Street, Ione, California. The premises were purchased April 1, 1995. The purchase price for the land and building was \$167,500. The building consists of 2,576 square feet. The land consists of 9,700 square feet.

The leases on the premises located at 1545 River Park Drive, 9750 Business Park Drive, 90 South E Street, 26395 Buckhorn Ridge Road, 11220 Gold River Express Drive, 520 Capitol Mall, 422 Sutter Street, and 3100 Zinfandel Drive, contain options to extend for five years. Included in the above premises are two facilities leased from current or former directors of the Company at terms and conditions which management believes are consistent with the commercial lease market. The foregoing summary descriptions of leased premises are qualified in their entirety by reference to the lease agreements listed as exhibits in Part IV, Item 15 of this Annual Report on Form 10-K.

### Item 3. Legal Proceedings.

There are no material legal proceedings adverse to the Company and its subsidiaries to which any director, officer, affiliate of the Company, or 5% shareholder of the Company or its subsidiaries, or any associate of any such director, officer, affiliate or 5% shareholder of the Company or its subsidiaries are a party, and none of the above persons has a material interest adverse to the Company or its subsidiaries.

From time to time, the Company and/or its subsidiaries may be a party to claims and legal proceedings arising in the ordinary course of business. The Company's management is not aware of any pending legal proceedings to which either it or its subsidiaries may be a party or has recently been a party, which will have a material adverse effect on the financial condition or results of operations of the Company or its subsidiaries.

### 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.****Market Information**

The Company's common stock began trading on the NASDAQ National Stock Market ("Nasdaq") under the symbol "AMRB" on October 26, 2000. Effective July 3, 2006, the Company's common stock became listed and traded on the Nasdaq Global Select Market. The following table shows the high and the low prices for the common stock, for each quarter during 2012 and 2013, as reported by Nasdaq.

2012	High	Low
First quarter	\$7.90	\$4.50
Second quarter	8.31	6.25
Third quarter	7.71	6.41
Fourth quarter	7.89	6.21

2013	High	Low
First quarter	\$7.95	\$6.75
Second quarter	9.53	7.39
Third quarter	8.91	8.62
Fourth quarter	9.58	7.89

The closing price for the Company's common stock on February 26, 2014 was \$9.84.

 **Holders**

As of February 24, 2014, there were approximately 2,400 shareholders of record of the Company's common stock.

 **Dividends**

The Company paid quarterly cash dividends on its common stock from the first quarter of 2004 through the second quarter of 2009. Prior to that, the Company paid cash dividends twice a year since 1992. On July 27, 2009, the Company announced that the Board of Directors had suspended the payment of cash dividends, until such time that it was prudent to reestablish the payment of cash dividends. The Company relies on distributions from the Bank in the form of cash dividends in order to pay cash dividends to our shareholders. In 2013 and 2012, there were no cash dividends paid to our shareholders. It is uncertain whether any dividends will be paid in the future since they are subject to regulatory and statutory restrictions and the evaluation by the Company's Board of Directors of financial factors including, but not limited to earnings, financial condition and capital requirements of the Company and its subsidiaries.

As a California corporation, the Company's ability to pay cash dividends is subject to restrictions set forth in the California General Corporation Law (the "Corporation Law"). The Corporation Law provides that neither a corporation nor any of its subsidiaries shall make a distribution to the corporation's shareholders unless the board of directors has determined in good faith either of the following: (1) the amount of retained earnings of the corporation immediately prior to the distribution equals or exceeds the sum of (A) the amount of the proposed distribution plus (B) the preferential dividends arrears amount; or (2) immediately after the distribution, the value of the corporation's assets would equal or exceed the sum of its total liabilities plus the preferential rights amount. The good faith determination of the board of directors may be based upon (1) financial statements prepared on the basis of reasonable accounting practices and principles, (2) a fair valuation, or (3) any other method reasonable under the circumstances; provided, that a distribution may not be made if the corporation or subsidiary making the distribution is, or is likely to be, unable to meet its liabilities (except those whose payment is otherwise adequately provided for) as they mature.

The term "preferential dividends arrears amount" means the amount, if any, of cumulative dividends in arrears on all shares having a preference with respect to payment of dividends over the class or series to which the applicable distribution is being made, provided that if the articles of incorporation provide that a distribution can be made without regard to preferential dividends arrears amount, then the preferential dividends arrears amount shall be zero.

The term “preferential rights amount” means the amount that would be needed if the corporation were to be dissolved at the time of the distribution to satisfy the preferential rights, including accrued but unpaid dividends, of other shareholders upon dissolution that are superior to the rights of the shareholders receiving the distribution, provided that if the articles of incorporation provide that a distribution can be made without regard to any preferential rights, then the preferential rights amount shall be zero.

The Board of Governors generally prohibits a bank holding company from declaring or paying a cash dividend which would impose undue pressure on the capital of subsidiary banks or would be funded only through borrowing or other arrangements that might adversely affect a bank holding company’s financial position. The Board of Governors’ policy is that a bank holding company should not continue its existing rate of cash dividends on its common stock unless its net income is sufficient to fully fund each dividend and its prospective rate of earnings retention appears consistent with its capital needs, asset quality and overall financial condition.

The payment of cash dividends by American River Bank is subject to restrictions set forth in the California Financial Code (the “Financial Code”). The Financial Code provides that a bank may not make a cash distribution to its shareholders in excess of the lesser of (a) the bank’s retained earnings; or (b) the bank’s net income for its last three fiscal years, less the amount of any distributions made by the bank or by any majority-owned subsidiary of the bank to the shareholders of the bank during such period. However, a bank may, with the approval of the Commissioner, make a distribution to its shareholders in an amount not exceeding the greater of (a) its retained earnings; (b) its net income for its last fiscal year; or (c) its net income for its current fiscal year. In the event that the Commissioner determines that the shareholders’ equity of a bank is inadequate or that the making of a distribution by the bank would be unsafe or unsound, the Commissioner may order the bank to refrain from making a proposed distribution.

The FDIC may also restrict the payment of dividends by a subsidiary bank if such payment would be deemed unsafe or unsound or if after the payment of such dividends, the bank would be included in one of the “undercapitalized” categories for capital adequacy purposes pursuant to the FDIC Improvement Act of 1991.

### Stock Repurchases

On December 20, 2012, the Company approved and authorized a stock repurchase program for 2013 (the “2013 Program”). The 2013 Program authorized the repurchase during 2013 of up to 10% of the outstanding shares of the Company’s common stock. During 2013, the Company repurchased 849,404 shares of its common stock at an average price of \$8.24 per share. Repurchases under the 2013 Program were made from time to time by the Company in the open market. All such transactions were structured to comply with Securities and Exchange Commission Rule 10b-18 and all shares repurchased under the 2013 Program were retired. The following table lists shares repurchased during the quarter ended December 31, 2013 and the maximum amount available to repurchase under the repurchase plan.

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) That May Yet Be Purchased Under the Plans or Programs
Month #1				
October 1 through October 31, 2013	78,541	\$ 8.70	78,541	349,090
Month #2				

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November 1 through November 30, 2013 Month #3	180,774	\$ 8.84	180,774	168,316
December 1 through December 31, 2013	85,000	\$ 9.35	85,000	83,316
Total	344,315	\$ 8.94	344,315	N/A

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The Company did not repurchase any of its shares in 2011, 2010 or in 2009. Share amounts have been adjusted for stock dividends and/or splits.

On January 17, 2014, the Company approved and authorized a stock repurchase program for 2014 (the “2014 Program”). The 2014 Program authorizes the repurchase during 2014 of up to 5% of the outstanding shares of the Company’s common stock, or approximately 424,462 shares based on the 8,489,247 shares outstanding as of December 31, 2013. Any repurchases under the 2014 Program will be made from time to time by the Company in the open market as conditions allow. All such transactions will be structured to comply with Commission Rule 10b-18 and all shares repurchased under the 2014 Program will be retired. The number, price and timing of the repurchases will be at the Company’s sole discretion and the 2014 Program may be re-evaluated depending on market conditions, capital and liquidity needs or other factors. Based on such re-evaluation, the Board of Directors may suspend, terminate, modify or cancel the 2014 Program at any time without notice.

**Item 6. Selected Financial Data.**

**FINANCIAL SUMMARY**-The following table presents certain consolidated financial information concerning the business of the Company and its subsidiaries. This information should be read in conjunction with the Consolidated Financial Statements, the notes thereto, and Management's Discussion and Analysis included in this report. All per share data has been retroactively restated to reflect stock dividends and stock splits.

**As of and for the Years Ended December 31,**

(In thousands, except per share amounts and ratios)

	2013	2012	2011	2010	2009	
<b>Operations Data:</b>						
Net interest income	\$17,391	\$19,405	\$21,591	\$22,256	\$24,032	
Provision for loan and lease losses	200	1,365	3,625	7,365	8,530	
Noninterest income	2,015	2,774	2,108	1,804	2,269	
Noninterest expenses	14,891	16,747	16,301	16,470	15,811	
Income before income taxes	4,315	4,067	3,773	225	1,960	
Income tax expense (benefit)	1,258	860	1,269	(251)	374	
Net income	\$3,057	\$3,207	\$2,504	\$476	\$1,586	
<b>Share Data:</b>						
Earnings per share – basic	\$0.34	\$0.34	\$0.25	\$0.05	\$0.26	
Earnings per share – diluted	\$0.34	\$0.34	\$0.25	\$0.05	\$0.26	
Cash dividends per share (1)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.29	
Book value per share	\$10.25	\$10.08	\$9.51	\$9.07	\$8.87	
Tangible book value per share	\$8.33	\$8.33	\$7.85	\$7.37	\$7.15	
<b>Balance Sheet Data:</b>						
Assets	\$592,753	\$596,389	\$581,518	\$578,940	\$594,418	
Loans and leases, net	251,747	252,118	293,731	338,533	376,322	
Deposits	483,690	478,256	462,285	465,122	469,755	
Shareholders' equity	87,020	93,994	94,099	89,544	87,345	
<b>Financial Ratios:</b>						
Return on average equity	3.38	% 3.42	% 2.74	% 0.53	% 2.44	%
Return on average tangible equity	4.13	% 4.15	% 3.35	% 0.66	% 3.31	%
Return on average assets	0.52	% 0.55	% 0.43	% 0.08	% 0.28	%
Efficiency ratio (2)	75.61	% 73.69	% 67.18	% 66.87	% 58.45	%
Net interest margin (2) (3)	3.45	% 3.91	% 4.36	% 4.49	% 4.90	%
Net loans and leases to deposits	52.05	% 52.72	% 63.54	% 72.78	% 80.11	%
Net charge-offs to average loans & leases	0.25	% 0.93	% 1.29	% 2.12	% 1.62	%
Non-performing loans and leases to total loans and leases (4)	0.77	% 2.12	% 4.46	% 6.52	% 5.46	%
Allowance for loan and lease losses to total loans and leases	2.08	% 2.24	% 2.34	% 2.19	% 2.06	%
Average equity to average assets	15.31	% 15.97	% 15.81	% 15.28	% 11.36	%
Dividend payout ratio (1)	0	% 0	% 0	% 0	% 109	%

Capital Ratios:

Leverage capital ratio	11.88	%	12.82	%	13.09	%	12.55	%	12.45	%
Tier 1 risk-based capital ratio	21.95	%	23.87	%	21.52	%	19.07	%	17.13	%
Total risk-based capital ratio	23.20	%	25.13	%	22.78	%	20.33	%	18.39	%

- (1) On July 27, 2009, the Company announced that the Board of Directors suspended the payment of cash dividends, until such time that it was prudent to reestablish the payment of cash dividends.
- (2) Fully taxable equivalent.
- (3) Excludes the amortization of intangible assets.
- (4) Non-performing loans and leases consist of loans and leases past due 90 days or more and still accruing and nonaccrual loans and leases.

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## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

### **Cautionary Statements Regarding Forward-Looking Statements**

Certain matters discussed or incorporated by reference in this Annual Report on Form 10-K including, but not limited to, matters described in "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations," are "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, Section 27A of the Securities Act of 1933, as amended, and subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements may contain words related to future projections including, but not limited to, words such as "believe," "expect," "anticipate," "intend," "may," "will," "should," "could," "would," and variations of those words and similar words that are subject to risks, uncertainties and other factors that could cause actual results to differ materially from those projected. Factors that could cause or contribute to such differences include, but are not limited to, the following: (1) the duration of financial and economic instability and actions taken by the United States Congress and governmental agencies, including the United States Department of the Treasury, to deal with challenges to the U.S. financial system; (2) the risks presented by a continued economic recession, which could adversely affect credit quality, collateral values, including real estate collateral, investment values, liquidity and loan originations and loan portfolio delinquency rates; (3) variances in the actual versus projected growth in assets and return on assets; (4) potential continued or increasing loan and lease losses; (5) potential increasing levels of expenses associated with resolving non-performing assets as well as regulatory changes; (6) changes in the interest rate environment including interest rates charged on loans, earned on securities investments and paid on deposits and other borrowed funds; (7) competitive effects; (8) potential declines in fee and other noninterest income earned associated with economic factors as well as regulatory changes; (9) general economic conditions nationally, regionally, and within our operating markets could be less favorable than expected or could have a more direct and pronounced effect on us than expected and adversely affect our ability to continue internal growth at historical rates and maintain the quality of our earning assets; (10) changes in the regulatory environment including government intervention in the U.S. financial system; (11) changes in business conditions and inflation; (12) changes in securities markets, public debt markets, and other capital markets; (13) potential data processing and other operational systems failures or fraud; (14) potential continued decline in real estate values in our operating markets; (15) the effects of uncontrollable events such as terrorism, the threat of terrorism or the impact of the military conflicts in Afghanistan and Iraq and the conduct of the war on terrorism by the United States and its allies, worsening financial and economic conditions, natural disasters, and disruption of power supplies and communications; (16) changes in accounting standards, tax laws or regulations and interpretations of such standards, laws or regulations; (17) projected business increases following any future strategic expansion could be lower than expected; (18) the goodwill we have recorded in connection with acquisitions could become impaired, which may have an adverse impact on our earnings; (19) the reputation of the financial services industry could experience further deterioration, which could adversely affect our ability to access markets for funding and to acquire and retain customers; (20) the efficiencies we may expect to receive from any investments in personnel and infrastructure may not be realized; and (21) downgrades in the credit rating of the United States by credit rating agencies.

The factors set forth under "Item 1A - Risk Factors" in this report and other cautionary statements and information set forth in this report should be carefully considered and understood as being applicable to all related forward-looking statements contained in this report, when evaluating the business prospects of the Company and its subsidiaries.

Forward-looking statements are not guarantees of performance. By their nature, they involve risks, uncertainties and assumptions. The future results and shareholder values may differ significantly from those expressed in these forward-looking statements. You are cautioned not to put undue reliance on any forward-looking statement. Any such

statement speaks only as of the date of this report, and in the case of any documents that may be incorporated by reference, as of the date of those documents. We do not undertake any obligation to update or release any revisions to any forward-looking statements, to report any new information, future event or other circumstances after the date of this report or to reflect the occurrence of unanticipated events, except as required by law. However, your attention is directed to any further disclosures made on related subjects in our subsequent reports filed with the Securities and Exchange Commission (the “SEC”) on Forms 10-K, 10-Q and 8-K.

## Critical Accounting Policies

### *General*

The Company'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. We use historical loss data and the economic environment as factors, among others, in determining the inherent loss that may be present in our loan and lease portfolio. Actual losses could differ significantly from the 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.

### *Allowance for Loan and Lease Losses*

The allowance for loan and lease losses is an estimate of the credit loss risk in our loan and lease portfolio. The allowance is based on two basic principles of accounting: (1) "Accounting for Contingencies," which requires that losses be accrued when it is probable that a loss has occurred at the balance sheet date and such loss can be reasonably estimated; and (2) the "Receivables" topic, which requires that losses be accrued on impaired loans 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.

The allowance for loan and lease losses is determined based upon estimates that can and do change when the actual risk, loss events, or changes in other factors, occur. The analysis of the allowance uses an historical loss view as an indicator of future losses and as a result could differ from the actual losses incurred in the future. If the allowance for loan and lease losses falls below that deemed adequate (by reason of loan and lease growth, actual losses, the effect of changes in risk factors, or some combination of these), the Company has a strategy for supplementing the allowance for loan and lease losses, over the short-term. For further information regarding our allowance for loan and lease losses, see "Allowance for Loan and Lease Losses Activity."

### *Stock-Based Compensation*

The Company recognizes compensation expense over the service period in an amount equal to the fair value of all share-based payments which consist of stock options and restricted stock awarded to directors and employees. The fair value of each stock option award is estimated on the date of grant and amortized over the service period using a Black-Scholes-Merton based option valuation model that requires the use of assumptions. Critical assumptions that affect the estimated fair value of each award include expected stock price volatility, dividend yields, option life and the risk-free interest rate. The fair value of each restricted award is estimated on the date of award and amortized over the service period.

### *Goodwill*

Business combinations involving the Company's acquisition of equity interests or net assets of another enterprise or the assumption of net liabilities in an acquisition of branches constituting a business may give rise to goodwill. Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. The value of goodwill is ultimately derived from the Company's ability to generate net

earnings after the acquisition and is not deductible for tax purposes. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed for impairment at least annually. Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value. At December 31, 2013, the Company's reporting unit had positive equity and the Company elected to perform a qualitative assessment to determine if it was more likely than not that the fair value of the reporting unit exceeded its carrying value, including goodwill. The qualitative assessment indicated that it was more likely than not that the fair value of the reporting unit exceeded its carrying value, resulting in no impairment.

#### *Income Taxes*

The Company files its income taxes on a consolidated basis with its subsidiaries. The allocation of income tax expense (benefit) represents each entity's proportionate share of the consolidated provision for income taxes.

The Company accounts for income taxes using the balance sheet method, under which deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some or all of the deferred tax assets will not be realized. The Company conducted an analysis to assess the need for a valuation allowance at December 31, 2013, and determined that no valuation allowance was required. As part of this assessment, all available evidence, including both positive and negative, was considered to determine whether based on the weight of such evidence, a valuation allowance on the Company's deferred tax assets was needed. A valuation allowance is deemed to be needed when, based on the weight of the available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of a deferred tax asset will not be realized. The future realization of the deferred tax asset depends on the existence of sufficient taxable income within the carryback and carry forward periods.

The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Only tax positions that meet the more-likely-than-not recognition threshold are recognized. The election has been made to record interest expense related to tax exposures in tax expense, if applicable, and the exposure for penalties related to tax exposures in tax expense, if applicable.

## Overview

The Company recorded net income in 2013 of \$3,057,000, a decrease of \$150,000 (4.37%) from \$3,207,000 in 2012. Diluted earnings per share for 2013 and 2012 were \$0.34. For 2013, the Company realized a return on average equity of 3.38% and a return on average assets of 0.52%, as compared to 3.42% and 0.55% for 2012.

Net income for 2012 was \$703,000 (28.1%) higher than the \$2,504,000 recorded in 2011. In 2011, diluted earnings per share were \$0.25, return on average assets was 0.43% and return on average equity was 2.74%. Table One below provides a summary of the components of net income for the years indicated (dollars in thousands):

**Table One: Components of Net Income**

	2013	2012	2011
Interest income*	\$19,170	\$21,597	\$24,438
Interest expense	(1,490 )	(1,894 )	(2,608 )
Net interest income*	17,680	19,703	21,830
Provision for loan and lease losses	(200 )	(1,365 )	(3,625 )
Noninterest income	2,015	2,774	2,108



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Noninterest expense	(14,891 )	(16,747 )	(16,301 )
Provision for income taxes	(1,258 )	(860 )	(1,269 )
Tax equivalent adjustment	(289 )	(298 )	(239 )
Net income	\$3,057	\$3,207	\$2,504
Average total assets	\$590,411	\$586,989	\$578,217
Net income as a percentage of average total assets	0.52 %	0.55 %	0.43 %
* Fully taxable equivalent basis (FTE)			

Under accounting principles generally accepted in the United States of America all share and per share data is adjusted for stock dividends and stock splits. There were no stock dividends or stock splits in 2013, 2012 or 2011.

During 2013, total assets of the Company decreased \$3,636,000 (0.6%) to a total of \$592,753,000 at year-end. At December 31, 2013, net loans totaled \$251,747,000, down \$374,000 (0.1%) from the ending balance on December 31, 2012. Deposits increased \$5,434,000 or 1.1% during 2013 resulting in ending deposit balances of \$483,690,000. Shareholders' equity decreased \$6,974,000 or 7.4% during 2013, to end the year at \$87,020,000. The Company ended 2013 with a leverage capital ratio of 11.9% and a total risk-based capital ratio of 23.2% compared to a leverage capital ratio of 12.8% and a total risk-based capital ratio of 25.1% at the end of 2012.

## Results of Operations

### Net Interest Income and Net Interest Margin

Net interest income represents the excess of interest and fees earned on interest earning assets (loans, securities, Federal funds sold and interest-bearing deposits in other banks) over the interest paid on deposits and borrowed funds. Net interest margin is net interest income expressed as a percentage of average earning assets.

The Company's fully taxable equivalent net interest margin was 3.45% in 2013, 3.91% in 2012, and 4.36% in 2011. The fully taxable equivalent net interest income was down \$2,023,000 (10.3%) in 2013 compared to 2012. The fully taxable equivalent net interest income was down \$2,127,000 (9.7%) in 2012 compared to 2011.

The fully taxable equivalent interest income component decreased from \$21,597,000 in 2012 to \$19,170,000 in 2013, representing a 11.2% decrease. The decrease in the fully taxable equivalent interest income for 2013 compared to the same period in 2012 is comprised of two components - rate (down \$1,395,000) and volume (down \$1,032,000). The rate decrease can be attributed to the overall lower interest rate environment and lower average loan balances replaced with higher average investment securities. While forgone interest on nonaccrual loans has decreased, it continues to negatively impact the yield on earning assets. During 2013, foregone interest income on nonaccrual loans was approximately \$327,000, compared to foregone interest of \$715,000 during 2012. The average balance of earning assets increased 1.5% from \$504,533,000 in 2012 to \$511,868,000 in 2013; however, the Company continues to see a change in the average earning asset mix. There was an increase in investment securities, offset by a decrease in loan balances. Principal reductions from loan balances were invested into investment securities. When compared to 2012, average loan balances were down \$29,329,000 (10.4%) to \$252,807,000 for 2013 and average investment securities were up \$36,776,000 (16.6%) to \$258,163,000 for 2013. The overall low interest rate environment, the negative effect of the foregone interest on loans, and the change in the asset mix (lower loan totals and higher investment security totals) resulted in a 53 basis point decrease in the yield on average earning assets from 4.28% for 2012 to 3.75% for 2013. The volume decrease of \$1,032,000 occurred mainly as a result of the decrease in average loans. The markets in which the Company operates are seeing marginal demand for new loans while existing borrowers continue to pay down debt and delay expansion plans.

The fully taxable equivalent interest income component decreased from \$24,438,000 in 2011 to \$21,597,000 in 2012, representing an 11.6% decrease. The decrease in the fully taxable equivalent interest income for 2012 compared to the same period in 2011 is comprised of two components - rate (down \$1,865,000) and volume (down \$976,000). The rate decrease can be attributed to the overall lower interest rate environment and lower average loan balances replaced with higher average investment securities. While forgone interest on nonaccrual loans has decreased, it continues to negatively impact the yield on earning assets. During 2012, foregone interest income on nonaccrual loans was approximately \$715,000, compared to foregone interest of \$1,706,000 during 2011. The average balance of earning assets increased 0.9% from \$500,200,000 in 2011 to \$504,533,000 in 2012; however, there was a significant change in the average earning asset mix in 2012. There was an increase in investment securities, offset by a decrease in loan balances. Principal reductions from loan balances were invested into investment securities. When compared to 2011, average loan balances were down \$41,174,000 (12.7%) to \$282,136,000 for 2012 and average investment securities were up \$46,461,000 (26.6%) to \$221,396,000 for 2012. The overall low interest rate environment, the negative effect of the foregone interest on loans, and the change in the asset mix (lower loan totals and higher investment security totals) resulted in a 61 basis point decrease in the yield on average earning assets from 4.89% for 2011 to 4.28% for 2012. The volume decrease of \$976,000 occurred mainly as a result of the decrease in average loans.

Interest expense was \$404,000 (21.3%) lower in 2013 compared to 2012. The average balances on interest bearing liabilities was slightly higher in 2013 (\$349,329,000) compared to 2012 (\$349,212,000). The slightly higher balances, however, did not increase interest expense as the increases occurred in lower cost savings accounts, which were slightly offset by decreases in higher cost time deposits. Despite the increase in average interest bearing balances the Company experienced a decrease in interest expense of \$13,000 due to this increase in interest checking and money market balances offset by the decrease in time deposits. The overall decrease in interest expense was mainly due to lower rates, which accounted for a \$391,000 decrease in interest expense for 2013 compared to 2012. Rates paid on interest-bearing liabilities decreased 11 basis points from 0.54% in 2012 to 0.43% in 2013.

Interest expense was \$714,000 (27.4%) lower in 2012 compared to 2011. The average balances on interest bearing liabilities was slightly higher in 2012 (\$349,212,000) compared to 2011 (\$349,075,000). The slightly higher balances, however, did not increase interest expense as the increases occurred in lower cost savings accounts, which were slightly offset by decreases in higher cost time deposits and other borrowings. Despite the increase in average interest bearing balances the Company experienced a decrease in interest expense of \$31,000 due to this increase in savings balance offset by the decrease in time deposits and other borrowings. Average savings balances increased \$4,308,000 (9.2%) during 2012 compared to 2011; while average time deposits decreased \$2,897,000 (2.8%) and other borrowings decreased \$731,000 (4.3%) during the same time period. The decrease in interest expense was mainly due to lower rates, which accounted for a \$683,000 decrease in interest expense for 2012 compared to 2011. Rates paid on interest-bearing liabilities decreased 21 basis points from 0.75% in 2011 to 0.54% in 2012.

Table Two, Analysis of Net Interest Margin on Earning Assets, and Table Three, Analysis of Volume and Rate Changes on Net Interest Income and Expenses, are provided to enable the reader to understand the components and past trends of the Company's interest income and expenses. Table Two provides an analysis of net interest margin on earning assets setting forth average assets, liabilities and shareholders' equity; interest income earned and interest expense paid and average rates earned and paid; and the net interest margin on earning assets. Table Three sets forth a summary of the changes in interest income and interest expense from changes in average asset and liability balances (volume), computed on a daily average basis, and changes in average interest rates.

**Table Two: Analysis of Net Interest Margin on Earning Assets**

Year Ended December 31,	2013			2012			2011		
(Taxable Equivalent Basis) (dollars in thousands)	Avg Balance	Interest	Avg Yield	Avg Balance	Interest	Avg Yield	Avg Balance	Interest	Avg Yield
Assets:									
Earning assets:									
Loans and leases (1)	\$ 252,807	\$ 14,191	5.61 %	\$ 282,136	\$ 16,687	5.91 %	\$ 323,310	\$ 19,235	5.95 %
Taxable investment securities	229,518	3,822	1.67 %	191,861	3,708	1.93 %	155,428	4,225	2.72 %
Tax-exempt investment securities (2)	28,607	1,142	3.99 %	29,535	1,190	4.03 %	19,507	959	4.92 %
Corporate stock	38	12	31.58 %	9	4	44.44 %	16	—	—
Federal funds sold	—	—	—	—	—	—	—	—	—
Interest bearing deposits in other banks	898	3	0.33 %	992	8	0.81 %	1,939	19	0.98 %
Total earning assets	511,868	19,170	3.75 %	504,533	21,597	4.28 %	500,200	24,438	4.89 %
Cash & due from banks	37,609			41,010			41,932		
Other assets	46,703			47,853			43,941		
Allowance for loan & lease losses	(5,769 )			(6,407 )			(7,856 )		
	\$590,411			\$586,989			\$578,217		
Liabilities & Shareholders' Equity:									
Interest bearing liabilities:									
NOW & MMDA	\$185,671	475	0.26 %	\$182,379	658	0.36 %	\$182,922	1,044	0.57 %
Savings	51,432	67	0.13 %	50,976	114	0.22 %	46,668	183	0.39 %
Time deposits	95,415	655	0.69 %	99,548	838	0.84 %	102,445	1,011	0.99 %
Other borrowings	16,811	293	1.74 %	16,309	284	1.74 %	17,040	370	2.17 %
Total interest bearing liabilities	349,329	1,490	0.43 %	349,212	1,894	0.54 %	349,075	2,608	0.75 %
Demand deposits	144,710			138,188			131,493		
Other liabilities	5,978			5,851			6,204		
Total liabilities	500,017			493,251			486,772		
Shareholders' equity	90,394			93,738			91,445		
	\$590,411			\$586,989			\$578,217		
Net interest income & margin (3)		\$17,680	3.45 %		\$19,703	3.91 %		\$21,830	4.36 %

(1) Loan and lease interest includes loan and lease fees of \$119,000, \$174,000 and \$95,000 in 2013, 2012 and 2011, respectively.

(2) Includes taxable-equivalent adjustments that primarily relate to income on certain securities that is exempt from federal income taxes. The effective federal statutory tax rate was 34% in 2013, 2012 and 2011.

(3) Net interest margin is computed by dividing net interest income by total average earning assets.



Table Three: Analysis of Volume and Rate Changes on Net Interest Income and Expenses

Year ended December 31, 2013 over 2012 (dollars in thousands)

Increase (decrease) in interest income and expense due to change in:

Interest-earning assets:	Volume	Rate (4)	Net Change
Net loans and leases (1)(2)	\$(1,735)	\$(761 )	\$( 2,496 )
Taxable investment securities	728	(614 )	114
Tax-exempt investment securities (3)	(37 )	(11 )	(48 )
Corporate stock	13	(5 )	8
Federal funds sold & other	—	—	—
Interest bearing deposits in other banks	(1 )	(4 )	(5 )
Total	(1,032)	(1,395 )	(2,427 )

Interest-bearing liabilities:

Demand deposits	12	(195 )	(183 )
Savings deposits	1	(48 )	(47 )
Time deposits	(35 )	(148 )	(183 )
Other borrowings	9	—	9
Total	(13 )	(391 )	(404 )
Interest differential	\$(1,019)	\$(1,004 )	\$( 2,023 )

Year Ended December 31, 2012 over 2011 (dollars in thousands)

Increase (decrease) in interest income and expense due to change in:

Interest-earning assets:	Volume	Rate (4)	Net Change
Net loans and leases (1)(2)	\$(2,450)	\$(98 )	\$( 2,548 )
Taxable investment securities	990	(1,507 )	(517 )
Tax-exempt investment securities (3)	493	(262 )	231
Corporate stock	—	4	4
Federal funds sold & other	—	—	—
Interest bearing deposits in other banks	(9 )	(2 )	(11 )
Total	(976 )	(1,865 )	(2,841 )

Interest-bearing liabilities:

Demand deposits	(3 )	(383 )	(386 )
Savings deposits	17	(86 )	(69 )
Time deposits	(29 )	(144 )	(173 )
Other borrowings	(16 )	(70 )	(86 )
Total	(31 )	(683 )	(714 )
Interest differential	\$(945 )	\$(1,182 )	\$( 2,127 )

(1) The average balance of non-accruing loans and leases is immaterial as a percentage of total loans and leases and has been included in net loans and leases.

(2) Loan and lease fees of \$119,000, \$174,000 and \$95,000 for the years ended December 31, 2013, 2012 and 2011, respectively, have been included in the interest income computation.

(3) Includes taxable-equivalent adjustments that primarily relate to income on certain securities that is exempt from federal income taxes. The effective federal statutory tax rate was 34% in 2013, 2012 and 2011.

(4) The rate/volume variance has been included in the rate variance.

#### Provision for Loan and Lease Losses

The Company provided \$200,000 for loan and lease losses in 2013 as compared to \$1,365,000 for 2012. Net loan and lease losses for 2013 were \$635,000 as compared to \$2,625,000 in 2012. In 2013, net loan and lease losses as a percentage of average loans outstanding were 0.25% compared to 0.93% in 2012. In 2011, the Company provided \$3,625,000 for loan and lease losses and net charge-offs were \$4,168,000. The level of non-performing loans and leases, which began to increase during the recent economic cycle, reached a high of \$22,571,000 at December 31, 2010, but has decreased to \$1,979,000 at December 31, 2013. While the level of nonperforming loans and leases has decreased, there remains a challenging economy in the Company's market areas and in the United States, in general. This may potentially negatively impact the Company's borrowers and as a result the Company has maintained the ALLL at a level that is higher than the long-term historical averages. For additional information see the "Allowance for Loan and Lease Losses Activity."

## Service Charges and Fees and Other Income

Table Four below provides a summary of the components of noninterest income for the periods indicated (dollars in thousands):

**Table Four: Components of Noninterest Income**

	Year Ended December		
	2013	2012	2011
Service charges on deposit accounts	\$590	\$724	\$761
Rental income from OREO properties	316	886	37
Merchant fee income	443	531	467
Earnings on bank-owned life insurance	247	267	272
Life insurance death benefit	118	—	—
Gain on sale, impairment and call of securities	36	93	353
Other	265	273	218
	\$2,015	\$2,774	\$2,108

Noninterest income was down \$759,000 (27.4%) to \$2,015,000 in 2013 from the 2012 level. The decrease from 2012 to 2013 was primarily related to lower service charges on deposit accounts and decreased rental income from OREO properties. In 2013, service charges on deposit accounts were \$590,000 compared to \$724,000 in 2012 and rental income from OREO properties was \$316,000 in 2013 compared to \$886,000 in 2012. The decrease in service charges is primarily related to lower fees collected on checks drawn on insufficient funds and the decrease in income from the rental properties results primarily from lower rents received from foreclosed office buildings, as the Company has been able to sell some of the foreclosed properties. These decreases in 2013 were partially offset by higher income from bank owned life insurance, primarily from death benefit proceeds of a life insurance policy on a former director, resulting in tax-free income of \$118,000.

Noninterest income was up \$666,000 (31.6%) to \$2,774,000 in 2012 from the 2011 level. The increase from 2011 to 2012 was primarily related to increased rental income from OREO properties, partially offset by lower gains on sales of investment securities. Income from OREO properties was \$886,000 in 2012 compared to \$37,000 in 2011. The income from OREO properties results primarily from rents received on leased office properties the Company foreclosed upon between 2011 and 2012. The decrease in investment sales from \$353,000 in 2011 to \$93,000 in 2012, resulted from the Company selling selected municipal bonds to improve the credit quality of the securities portfolio and some mortgage related bonds to reinvest in mortgage bonds with better risk reward structures in 2011 and very few sales in 2012.

**Salaries and Benefits**

Salaries and benefits were \$8,516,000 (up \$256,000 or 3.1%) for 2013 as compared to \$8,260,000 in 2012. The increase in salary and benefits was due in part to increased incentive compensation expense partially offset by a decrease in core salaries. Salaries decreased \$221,000 (3.5%) from \$6,269,000 in 2012 to \$6,048,000 in 2013 and incentive accruals increased \$579,000, from \$39,000 in 2012 to \$618,000 in 2013. The decrease in salaries is related to a lower number of employees. Average full-time equivalent employees ("FTE") decreased from 114 during 2012 to 106 during 2013. The increase in incentive compensation was primarily due to an increase in the Company's net income in relationship to incentive targeted net income goals. The remaining decrease in salaries and benefits is related to a decrease in employee benefits, including employee health insurance and employer taxes. The actual FTE's decreased from 112 at the end of 2012 to 101 at the end of 2013.





Salaries and benefits were \$8,260,000 (down \$205,000 or 2.4%) for 2012 as compared to \$8,465,000 in 2011. The decrease in salary and benefits was due in part to decreased incentive compensation expense partially offset by an increase in core salaries and higher employment taxes, health insurance and general employee benefit expense. Incentive compensation accruals decreased \$428,000 from \$467,000 in 2011 to \$39,000 in 2012, primarily due to a decrease in the Company's net income in relationship to incentive targeted net income goals. Core salaries increased \$148,000 (2.4%) mainly due to normal merit increases and the addition of support staff. The remaining increase in salaries and benefits is related to an increase in employee benefits, including employee health insurance and employer taxes. The average FTE's increased from 111 during 2011 to 114 during 2012 and was 112 at the end of 2012, up from 110 at the end of 2011.

### **Other Real Estate Owned**

The total other real estate owned ("OREO") expense in 2013 was \$936,000 (down \$1,129,000 or 54.7%) compared to \$2,065,000 in 2012. The primary reason for the decrease in OREO related expenses is due to the sale of a number of properties, including office buildings which have high operating expenses and lower write-downs due to updated property valuations. In 2013, write-downs were \$293,000 compared to \$1,000,000 in 2012. This decrease is related to a fewer number of owned properties and some stability in the real estate market in 2013.

The total OREO expense in 2012 was \$2,065,000 (up \$777,000 or 60.3%) compared to \$1,288,000 in 2011. The increase in OREO expenses is directly related to the type of OREO properties the Company now owns. During 2011 and 2012, the Company acquired multiple office buildings which produce rental income, as reported above, but also require a significant amount of expense to maintain. Write-downs due to updated property valuations in 2012 were \$1,000,000 compared to \$978,000 in 2011.

### **Occupancy, Furniture and Equipment**

Occupancy expense increased \$3,000 (0.2%) during 2013 to \$1,212,000, compared to \$1,209,000 in 2012. Furniture and equipment expense was \$812,000 in 2012 compared to \$758,000 in 2013, representing a \$54,000 (6.7%) decrease. The decrease in the furniture and equipment expense resulted from lower depreciation on the Company's furniture and equipment.

Occupancy expense increased \$69,000 (6.1%) during 2012 to \$1,209,000, compared to \$1,140,000 in 2011. The majority of the increase relates to higher rent associated with the Company's banking offices due to normal annual increases (up \$39,000 or 4.7%). Furniture and equipment expense was \$812,000 in 2012 compared to \$719,000 in 2011, representing a \$93,000 (12.9%) increase. The increase in the furniture and equipment expense resulted from depreciation related to purchases of furniture and equipment, including software and three new ATM machines and higher maintenance costs related to the Company's software and equipment.

### **Regulatory Assessments**

Regulatory assessments include fees paid to the California Department of Business Oversight (the “DBO”), formerly the California Department of Financial Institutions and the Federal Deposit Insurance Corporation (the “FDIC”). FDIC assessments decreased \$252,000 (44.7%) during 2013 to \$312,000, compared to \$564,000 in 2012. The majority of this decrease relates to lower FDIC assessment methodology from a deposit based system to an asset risk-based system, the Bank’s improved risk assessment category, and an adjustment to the accrual based upon an updated analysis revealing that the accrual should be reduced. The assessments paid to the DBO in 2013 were \$70,000 compared to \$69,000 in 2012.

FDIC assessments decreased \$299,000 (34.6%) during 2012 to \$564,000, compared to \$863,000 in 2011. The majority of this decrease relates to lower assessed expense by the FDIC due to the Bank’s improved risk assessment category and an adjustment to the FDIC accrual based upon an updated analysis revealing that the accrual should be reduced. The assessments paid to the California Department of Financial Institutions in 2012 were \$69,000 compared to \$68,000 in 2011.

## Other Expenses

Table Five below provides a summary of the components of the other noninterest expenses for the periods indicated (dollars in thousands):

	Year Ended December		
	31, 2013	2012	2011
Professional fees	\$933	\$1,031	\$1,037
Telephone and postage	329	335	330
Directors' expense	348	384	327
Outsourced item processing	357	379	427
Advertising and promotion	284	268	231
Stationery and supplies	240	229	183
Amortization of intangible assets	—	183	219
Other operating expenses	596	959	1,004
	\$3,087	\$3,768	\$3,758

Other expenses were \$3,087,000 (down \$681,000 or 18.1%) for 2013 as compared to \$3,768,000 for 2012. The decrease in other expenses results from the Company's focus on reducing controllable expenses and a reduction in professional fees and expenses related to amortization of intangible assets. Professional expenses, which include legal expenses, are down \$98,000 (9.5%), from \$1,031,000 in 2012 to \$933,000 in 2013 and the expense related to the amortization of intangible assets decreased from \$183,000 during 2012 to zero in 2013. Legal expense decreased due to less credit related workouts in 2013 and the intangible asset related to the Bank of Amador acquisition in 2004 became fully depreciated in 2012. The overhead efficiency ratio on a taxable equivalent basis for 2013 was 75.6% as compared to 73.7% in 2012. Much of the increase in the overhead efficiency ratio is related to the decrease in the net interest margin and not as a result of an increase in noninterest expense.

Other expenses were \$3,768,000 (up \$10,000 or 0.3%) for 2012 as compared to \$3,758,000 for 2011. The increase in other expenses resulted from higher advertising and promotion and stationary and supplies expenses related to the Company's rebranding strategy in 2012 and increases in directors fees due to higher costs of directors services plus the addition of one new director in July 2012. These increases were partially offset by lower outsourced item processing (due to lower volume and more favorable pricing) and lower expenses related to amortization of intangible assets, which became fully depreciated in 2012. The overhead efficiency ratio on a taxable equivalent basis for 2012 was 73.7% as compared to 67.2% in 2011.

## Provision for Income Taxes

The effective tax rate on income was 29.2%, 21.1%, and 33.6% in 2013, 2012 and 2011, respectively. The effective tax rate differs from the federal statutory tax rate due to state tax expense (net of federal tax effect) of \$197,000, \$75,000, and \$287,000 in these years. Tax-exempt income of \$1,207,000, \$1,141,000, and \$1,006,000 from investment securities and bank-owned life insurance in these years helped to reduce the effective tax rate. The lower effective tax rate in 2012 resulted from the normal tax benefits such as the benefits of tax-free income related to municipal bonds, bank-owned life insurance, and the tax benefits of Enterprise Zone credits on the Company's State tax return from the hiring and the sales and use tax credits offered under the California Enterprise Zone program. In

2012, the Company not only realized the benefit for 2012, but also realized the benefit for credits from amended tax returns filed for 2009 and 2010 and the tax return filed for 2011.

### **Balance Sheet Analysis**

The Company's total assets were \$592,753,000 at December 31, 2013 as compared to \$596,389,000 at December 31, 2012, representing a decrease of \$3,636,000 (0.6%). The average balances of total assets during 2013 were \$590,411,000, up \$3,422,000 or 0.6% from the 2012 total of \$586,989,000.

## Investment Securities

The Company classifies its investment securities as trading, held-to-maturity or available-for-sale. The Company's intent is to hold all securities classified as held-to-maturity until maturity and management believes that it has the ability to do so. Securities classified as available-for-sale may be sold to implement asset/liability management strategies as part of our contingency funding plan and in response to changes in interest rates, prepayment rates and similar factors. Table Six below summarizes the values of the Company's investment securities held on December 31 of the years indicated. The Company did not have any investment securities classified as trading in any of the years indicated below.

Table Six: Investment Securities Composition  
(dollars in thousands)

Available-for-sale (at fair value)	2013	2012	2011
Debt securities:			
Mortgage-backed securities	\$244,160	\$200,515	\$179,454
Obligations of states and political subdivisions	26,903	29,656	29,188
Corporate debt securities	1,609	1,594	
Equity securities:			
Corporate stock	119	74	69
Total available-for-sale investment securities	\$272,791	\$231,839	\$208,711
Held-to-maturity (at amortized cost)			
Debt securities:			
Mortgage-backed securities	\$1,185	\$2,117	\$4,010
Total held-to-maturity investment securities	\$1,185	\$2,117	\$4,010

See Table Fifteen, "Securities Maturities and Weighted Average Yields," for a breakdown of the investment securities by maturity and the corresponding weighted average yields.

## Loans and Leases

The Company concentrates its lending activities in the following principal areas: (1) commercial; (2) commercial real estate; (3) multi-family real estate; (4) real estate construction (both commercial and residential); (5) residential real estate; (6) lease financing receivable; (7) agriculture; and (8) consumer loans. At December 31, 2013, these categories accounted for approximately 10%, 72%, 4%, 4%, 7%, 1%, 1% and 1%, respectively, of the Company's loan portfolio. This mix was relatively unchanged compared to 12%, 70%, 3%, 3%, 7%, 1%, 1% and 3%, at December 31, 2012. Continuing focus in the Company's market area, new borrowers developed through the Company's marketing efforts, and credit extensions expanded to existing borrowers resulted in the Company originating approximately \$64 million in new loans in 2013. Loan pay downs, charge-offs, and loans transferred to OREO during 2013, resulted in an overall decrease in total loans and leases of \$723,000 (0.3%) from December 31, 2012. The market in which the Company operates has begun to show demand for credit products as the continued low rate environment and expectations for economic expansion have increased refinancing as well as new loan activity. The Company reported net decreases in balances for commercial loans (\$6,266,000 or 20.3%), lease financing receivable (\$165,000 or 10.9%), agriculture (\$220,000 or 6.6%), and consumer loans (\$2,797,000 or 32.6%) and an increase in commercial real estate (\$4,078,000

or 2.3%), real estate construction (\$2,715,000 or 39.2%), residential real estate (\$2,000 or 0.0%), and multi-family real estate (\$1,930,000 or 21.1%). Table Seven below summarizes the composition of the loan and lease portfolio for the past five years as of December 31.

**Table Seven: Loan and Lease Portfolio Composition**

(dollars in thousands)	December 31,				
	2013	2012	2011	2010	2009
Commercial	\$24,545	\$30,811	\$42,108	\$58,261	\$72,621
Real estate:					
Commercial	184,204	180,126	204,043	216,076	223,685
Multi-family	11,085	9,155	7,580	6,968	8,476
Construction	9,633	6,918	10,356	15,971	27,482
Residential	17,703	17,701	19,695	26,099	26,922
Lease financing receivable	1,344	1,509	1,725	2,766	3,920
Agriculture	3,120	3,340	4,583	7,202	7,472
Consumer	5,772	8,569	10,984	13,202	14,253
	257,406	258,129	301,074	346,545	384,831
Deferred loan fees, net	(313 )	(230 )	(302 )	(427 )	(600 )
Allowance for loan and lease losses	(5,346 )	(5,781 )	(7,041 )	(7,585 )	(7,909 )
Total net loans and leases	\$251,747	\$252,118	\$293,731	\$338,533	\$376,322

A significant portion of the Company's loans and leases are direct loans and leases made to individuals and local businesses. The Company relies substantially on local promotional activity and personal contacts by American River Bank officers, directors and employees to compete with other financial institutions. The Company makes loans and leases to borrowers whose applications include a sound purpose and a viable primary repayment source, generally supported by a secondary source of repayment.

Commercial loans consist of credit lines for operating needs, loans for equipment purchases, working capital, and various other business loan products. Consumer loans include a range of traditional consumer loan products such as personal lines of credit and homeowner equity lines of credit and non-mortgage products to finance purchases of autos, boats, recreational vehicles, mobile homes and various other consumer items. Construction loans are generally comprised of commitments to customers within the Company's service area for construction of commercial properties, multi-family properties and custom and semi-custom single-family residences. Other real estate loans consist primarily of loans secured by first trust deeds on commercial and residential properties typically with maturities from 3 to 10 years and original loan-to-value ratios generally from 65% to 75%. Agriculture loans consist primarily of vineyard loans and development loans to plant vineyards. In general, except in the case of loans under SBA programs or Farm Services Agency guarantees, the Company does not make long-term fixed rate mortgage loans.

"Subprime" real estate loans generally refer to residential mortgages made to higher-risk borrowers with lower credit and/or income histories. Within the industry, many of these loans were originated with adjustable interest rates that reset upward after an introductory period. These "subprime" loans coupled with declines in housing prices have led to an increase in the banking industry's default rates resulting in many instances of increased foreclosure rates as the adjustable interest rates reset to higher levels. The Company did not have any such "subprime" loans at December 31, 2013 and December 31, 2012.



Average loans and leases in 2013 were \$252,807,000 which represents a decrease of \$29,329,000 (10.4%) compared to the average in 2012. Average loans and leases in 2012 were \$282,136,000 which represented a decrease of 41,174,000 (12.7%) from the average in 2011.

#### Risk Elements

The Company assesses and manages credit risk on an ongoing basis through a credit culture that emphasizes excellent credit quality, extensive internal monitoring and established formal lending policies. Additionally, the Company contracts with an outside loan review consultant to periodically review the existing loan and lease portfolio. Management believes its ability to identify and assess risk and return characteristics of the Company's loan and lease portfolio is critical for profitability and growth. Management strives to continue its emphasis on credit quality in the loan and lease approval process, through active credit administration and regular monitoring. With this in mind, management has designed and implemented a comprehensive loan and lease review and grading system that functions to continually assess the credit risk inherent in the loan and lease portfolio.

Ultimately, underlying trends in economic and business cycles influence credit quality. American River Bank's business is concentrated (i) in the Sacramento Metropolitan Statistical Area, which is a diversified economy, but with a large State of California government presence and employment base; (ii) in Sonoma County, which is focused on businesses within the two communities in which the Bank has offices (Santa Rosa and Healdsburg); and (iii) in Amador County, in which the Bank is primarily focused on businesses within the three communities in which it has offices (Jackson, Pioneer, and Ione). The economy of Sonoma County is diversified with professional services, manufacturing, agriculture and real estate investment and construction, while the economy of Amador County is reliant upon government, services, retail trade, manufacturing industries and Indian gaming. The Company has recently entered the Santa Clara, Contra Costa, and Alameda County markets with loan production offices in Campbell and Pleasanton. The economies of Santa Clara, Contra Costa and Alameda Counties are diversified with professional services, manufacturing, technology related companies, real estate investment and construction.

The Company has significant extensions of credit and commitments to extend credit that are secured by real estate. The ultimate repayment of these loans is generally dependent on personal or business cash flows or the sale or refinancing of the real estate. The Company monitors the effects of current and expected market conditions and other factors on the collectability of real estate loans. The more significant factors management considers involve the following: lease rates and terms, vacancy rates, absorption and sale rates and capitalization rates; real estate values, supply and demand factors, and rates of return; operating expenses; inflation and deflation; and sufficiency of repayment sources independent of the real estate including, in some instances, personal guarantees.

In extending credit and commitments to borrowers, the Company generally requires collateral and/or guarantees as security. The repayment of such loans is expected to come from cash flow or from proceeds from the sale of selected assets of the borrowers. The Company's requirement for collateral and/or guarantees is determined on a case-by-case basis in connection with management's evaluation of the creditworthiness of the borrower. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment, income-producing properties, residences and other real property. The Company secures its collateral by perfecting its security interest in business assets, obtaining deeds of trust, or outright possession among other legal means.

In management's judgment, a concentration exists in real estate loans which represented approximately 87% of the Company's loan and lease portfolio at December 31, 2013, up from approximately 83% at December 31, 2012. Management believes that the residential land and residential construction portion of the Company's loan portfolio carries more than the normal credit risk, due primarily to curtailed demand for new and resale residential property, a moderate supply of unsold residential land and high loan-to-value residential properties throughout the Company's market area. Management has responded by evaluating loans that it considers to carry any significant risk above the normal risk of collectability by taking actions where possible to reduce credit risk exposure by methods that include, but are not limited to, seeking liquidation of the loan by the borrower, seeking additional tangible collateral or other repayment support, converting the property through judicial or non-judicial foreclosure proceedings, and other collection techniques. Management currently believes that it maintains its allowance for loan and lease losses at levels adequate to reflect the loss risk inherent in its total loan portfolio.

A further decline in the economy in general, or a continued additional decline in real estate values in the Company's primary market areas, in particular, could continue to have an adverse impact on the collectability of real estate loans and require an increase in the provision for loan and lease losses. This could adversely affect the Company's future prospects, results of operations, profitability and stock price. Management believes that its lending practices and

underwriting standards are structured with the intent to minimize losses; however, there is no assurance that losses will not occur. The Company's loan practices and underwriting standards include, but are not limited to, the following: (1) maintaining a thorough understanding of the Company's service area and originating a significant majority of its loans within that area, (2) maintaining a thorough understanding of borrowers' knowledge, capacity, and market position in their field of expertise, (3) basing real estate loan approvals not only on market demand for the project, but also on the borrowers' capacity to support the project financially in the event it does not perform to expectations (whether sale or income performance), and (4) maintaining conforming and prudent loan-to-value and loan-to-cost ratios based on independent outside appraisals and ongoing inspection and analysis by the Company's lending officers or contracted third-party professionals.

## Nonaccrual, Past Due and Restructured Loans and Leases

Management places loans and leases on nonaccrual status when they become 90 days past due or if a loss is expected, unless the loan or lease is well secured and in the process of collection. Loans and leases are partially or fully charged off when, in the opinion of management, collection of such amount appears unlikely.

The recorded investments in nonaccrual loans and leases and loans and leases that were 90 days or more past due and on accrual totaled \$1,979,000 and \$5,474,000 at December 31, 2013 and 2012, respectively. Of the 1,979,000 in non-performing loans and leases at December 31, 2013, there were four real estate loans totaling \$977,000; four commercial loans totaling \$766,000 and four consumer loans totaling \$156,000. At December 31, 2012, the \$5,474,000 in non-performing loans consisted of eleven real estate loans totaling \$2,897,000; ten commercial loans totaling \$2,352,000; five consumer loans totaling \$222,000; and one lease totaling \$3,000.

The net interest due on nonaccrual loans and leases but excluded from interest income was approximately \$327,000 during 2013, \$715,000 during 2012, and \$1,706,000 during 2011. Interest income recognized from payments received on nonaccrual loans and leases was approximately \$161,000 in 2013, \$197,000 in 2012 and \$440,000 in 2011.

There were no loan or lease concentrations in excess of 10% of total loans and leases not otherwise disclosed as a category of loans and leases as of December 31, 2013. Management is not aware of any potential problem loans, which were accruing and current at December 31, 2013, where serious doubt exists as to the ability of the borrower to comply with the present repayment terms and that would result in a significant loss to the Company apart from those loans identified in the Bank's impairment analysis. Table Eight below sets forth nonaccrual loans and leases and loans and leases past due 90 days or more and on accrual as of year-end for the past five years.

**Table Eight: Non-Performing Loans and Leases**

(dollars in thousands)	December 31,				
	2013	2012	2011	2010	2009
Past due 90 days or more and still accruing:					
Commercial	\$80	\$—	\$—	\$—	\$—
Real estate	—	—	—	—	—
Lease financing receivable	—	—	—	—	—
Consumer and other	—	—	—	—	—
Nonaccrual:					
Commercial	766	2,352	2,775	3,491	6,143
Real estate	977	2,897	9,809	18,735	14,048
Lease financing receivable	—	3	17	28	55
Consumer and other	156	222	822	317	718
Total non-performing loans and leases	\$1,979	\$5,474	\$13,423	\$22,571	\$20,964

Management monitors the Company's performance metrics including those ratios related to non-performing loans and leases. From 2008 to 2010, the Company had experienced an increase in non-performing loans and leases. In 2011, the focused efforts of the previous years resulted in a decrease in these levels. In 2012 and 2013, the level of non-performing loans and leases continued to decrease to a level below the amount reported at December 31, 2008. However, the variations in the amount of non-performing loans and leases does not directly impact the level of the Company's allowance for loan and lease losses as management monitors each of the loans and leases for loss potential

or probability of loss on an individual basis using accounting principles generally accepted in the United States of America.

### **Impaired Loans and Leases**

The Company considers a loan to be impaired when, based on current information and events, it is probable that it will be unable to collect all amounts due (principal and interest) according to the original contractual terms of the loan or lease agreement. The measurement of impairment may be based on (i) the present value of the expected cash flows of the impaired loan or lease discounted at the loan's or lease's original effective interest rate, (ii) the observable market price of the impaired loan or lease, or (iii) the fair value of the collateral of a collateral-dependent loan. The Company does not apply this definition to smaller-balance loans or leases that are collectively evaluated for credit risk. In assessing whether a loan or lease is impaired, the Company typically reviews loans or leases graded substandard or lower with outstanding principal balances in excess of \$100,000, as well as, loans considered troubled debt restructures with outstanding principal balances in excess of \$25,000. The Company identifies troubled debt restructures by reviewing each renewal, modification, or extension of a loan with a screening document. This document is designed to identify any characteristic of such a loan that would qualify it as a troubled debt restructure. If the characteristics are not present that would qualify a loan as a troubled debt restructure, it is deemed to be a modification.

The recorded investment in loans and leases that were considered to be impaired totaled \$27,034,000 at December 31, 2013 and had a related valuation allowance of \$1,598,000. The average recorded investment in impaired loans and leases during 2013 was approximately \$27,975,000. As of December 31, 2012, the recorded investment in loans and leases that were considered to be impaired totaled \$26,553,000 and had a related valuation allowance of \$1,595,000. The average recorded investment in impaired loans and leases during 2012 was approximately \$26,756,000. As of December 31, 2011, the recorded investment in loans and leases that were considered to be impaired totaled \$30,085,000 and had a related valuation allowance of \$1,680,000. The average recorded investment in impaired loans and leases during 2011 was approximately \$31,956,000.

As of December 31, 2013, the Company had 24 TDRs and, of these, there were nine rate reductions totaling \$9,144,000, nine extensions totaling \$2,182,000, five conversions to amortizing loans totaling \$1,834,000 and one conversion from revolving line of credit to term loan totaling \$47,000. All were performing as agreed except for four extensions totaling \$759,000, one conversion to amortizing loans totaling \$195,000 and one conversion to a term loan totaling \$47,000. The Company will return TDRs to accrual status after the borrower makes six consecutive payments on the restructured loan or lease and has demonstrated the capacity to continue to make these payments, however, the loan will continue to be considered a TDR and classified as impaired.

#### **Allowance for Loan and Lease Losses Activity**

The Company maintains an allowance for loan and lease losses (“ALLL”) to cover probable losses inherent in the loan and lease portfolio, which is based upon management’s estimate of those losses. The ALLL is established through a provision for loan and lease losses and is increased by provisions charged against current earnings and recoveries and reduced by charge-offs. Actual losses for loans and leases can vary significantly from this estimate. The methodology and assumptions used to calculate the allowance are continually reviewed as to their appropriateness given the most recent losses realized and other factors that influence the estimation process. The model assumptions and resulting allowance level are adjusted accordingly as these factors change.

The adequacy of the ALLL and the level of the related provision for loan and lease losses is determined based on management’s judgment after consideration of numerous factors including, but not limited to: (i) local and regional economic conditions, (ii) the financial condition of the borrowers, (iii) loan impairment and the related level of expected charge-offs, (iv) evaluation of industry trends, (v) industry and other concentrations, (vi) loans and leases which are contractually current as to payment terms but demonstrate a higher degree of risk as identified by management, (vii) continuing evaluations of the performing loan portfolio, (viii) ongoing review and evaluation of problem loans identified as having loss potential, (ix) quarterly review by the Board of Directors, and (x) assessments by banking regulators and other third parties. Management and the Board of Directors evaluate the ALLL and determine its appropriate level considering objective and subjective measures, such as knowledge of the borrowers’ business, valuation of collateral, the determination of impaired loans or leases and exposure to potential losses.

The allowance for loan and lease losses totaled \$5,346,000 or 2.08% of total loans and leases at December 31, 2013, \$5,781,000 or 2.24% of total loans and leases at December 31, 2012, and \$7,041,000 or 2.34% at December 31, 2011. The decrease in the allowance for loan and lease losses from \$5,781,000 at December 31, 2012 to \$5,346,000 at December 31, 2013, was mainly due to a decrease in historical losses impacting the loss factor used in calculating the reserve on loans collectively valued for impairment. The Company establishes general and specific reserves in accordance with accounting principles generally accepted in the United States of America. The ALLL is composed of categories of the loan and lease portfolio based on loan type and loan rating; however, the entire allowance is available to cover actual loan and lease losses. While management uses available information to recognize possible losses on loans and leases, future additions to the allowance may be necessary, based on changes in economic conditions and other matters. In addition, various regulatory agencies, as an integral part of their examination process, periodically

review the Company's ALLL. Such agencies may require the Company to provide additions to the allowance based on their judgment of information available to them at the time of their examination.

The allowance for loans and leases as a percentage of non-performing loans and leases was 270.1% at December 31, 2013 and 105.6% at December 31, 2012. The allowance for loans and leases as a percentage of impaired loans and leases was 19.8% at December 31, 2013 and 21.8% at December 31, 2012. Of the total non-performing and impaired loans and leases outstanding as of December 31, 2013, there were \$1,450,000 in loans or leases that had been reduced by partial charge-offs of \$291,000. As these loan or lease balances are charged off the remaining balances, following analysis, normally do not require specific reserves and are not eligible for general reserves. The impact on credit ratios is such that the Company's allowance for loan and lease losses as a percentage may be lower, however, the partial charge-offs have reduced the potential future losses related to those credits.

At December 31, 2013, there were \$11,783,000 in impaired loans or leases that did not carry a specific reserve. Of this amount, \$305,000 were loans or leases that had previous partial charge-offs and \$11,478,000 in loans or leases that were analyzed and determined not to require a specific reserve or charge-off because the collateral value or discounted cash flow value exceeded the loan or lease balance. The Company has been operating in a market that has experienced significant decreases in real estate values of commercial, residential, land, and construction properties. As such, the Company is focused on monitoring collateral values for those loans considered collateral dependent. The collateral evaluations performed by the Company are updated as necessary, which is generally once every six months, and are reviewed by a qualified credit officer.

The Company's policy with regard to loan or lease charge-offs continues to be that a loan or lease is charged off against the allowance for loan and lease losses when management believes that the collectability of the principal is unlikely. As previously discussed in the "Impaired Loans and Leases" section, certain loans are evaluated for impairment. Generally, if a loan is collateralized by real estate, and considered collateral dependent, the impaired portion will be charged off to the allowance for loan and lease losses unless it is in the process of collection, in which case a specific reserve may be warranted. If the collateral is other than real estate and considered impaired, a specific reserve may be warranted.

It is the policy of management to maintain the allowance for loan and lease losses at a level believed to be adequate for known and inherent risks in the portfolio. Our methodology incorporates a variety of risk considerations, both quantitative and qualitative, in establishing an allowance for loan and lease losses that management believes is appropriate at each reporting date. Based on information currently available to analyze inherent credit risk, including economic factors, overall credit quality, historical delinquencies and a history of actual charge-offs, management believes that the provision for loan and lease losses and the allowance for loan and lease losses are prudent and adequate. Adjustments may be made based on differences from estimated loan and lease growth, the types of loans constituting this growth, changes in risk ratings within the portfolio, and general economic conditions. However, no prediction of the ultimate level of loans and leases charged off in future periods can be made with any certainty. Table Nine below summarizes, for the periods indicated, the activity in the ALLL.



**Table Nine: Allowance for Loan and Lease Losses**

(dollars in thousands)

	Year Ended December 31,				
	2013	2012	2011	2010	2009
Average loans and leases outstanding	\$252,807	\$282,136	\$323,310	\$362,445	\$404,539
Allowance for loan & lease losses at beginning of period	\$5,781	\$7,041	\$7,585	\$7,909	\$5,918
Loans and leases charged off:					
Commercial	377	302	713	2,570	2,944
Real estate	534	2,038	3,765	5,048	3,257
Consumer	1	505	—	173	216
Lease financing receivable	26	9	220	30	171
Total	938	2,854	4,698	7,821	6,588
Recoveries of loans and leases previously charged off:					
Commercial	215	21	163	63	33
Real estate	88	172	346	68	1
Consumer	—	30	—	1	8
Lease financing receivable	—	6	20	—	7
Total	303	229	529	132	49
Net loans and leases charged off	635	2,625	4,169	7,689	6,539
Additions to allowance charged to operating expenses	200	1,365	3,625	7,365	8,530
Allowance for loan and lease losses at end of period	\$5,346	\$5,781	\$7,041	\$7,585	\$7,909
Ratio of net charge-offs to average loans and leases outstanding	0.25	% 0.93	% 1.29	% 2.12	% 1.62
Provision for loan and lease losses to average loans and leases outstanding	0.08	% 0.48	% 1.12	% 2.03	% 2.11
Allowance for loan and lease losses to non-performing loans and leases, at end of period	2.08	% 2.24	% 2.34	% 2.19	% 2.06
Allowance for loan and lease losses to non-performing loans and leases, at end of period	270.14	% 105.61	% 52.45	% 33.60	% 37.73

As part of its loan review process, management has allocated the overall allowance based on specific identified problem loans and leases, qualitative factors, uncertainty inherent in the estimation process and historical loss data. A risk exists that future losses cannot be precisely quantified or attributed to particular loans or leases or classes of loans and leases. Management continues to evaluate the loan and lease portfolio and assesses current economic conditions that will affect management's conclusion as to future allowance levels. Table Ten below summarizes the allocation of the allowance for loan and lease losses for the five years ended December 31, 2013.

Table Ten: Allowance for Loan and Lease Losses by Loan Category  
(dollars in thousands)

	December 31, 2013		December 31, 2012		December 31, 2011			
	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans		
Commercial	\$921	10	% \$1,410	12	% \$1,620	14	%	
Real estate	4,171	87	% 4,003	83	% 4,794	80	%	
Agriculture	83	1	% 91	1	% 176	1	%	
Consumer	167	1	% 273	3	% 367	4	%	
Lease financing receivable	4	1	% 4	1	% 84	1	%	
Total allocated	\$5,346	100	% \$5,781	100	% \$7,041	100	%	

  

	December 31, 2010		December 31, 2009			
	Amount	Percent of loans in each category to total loans	Amount	Percent of loans in each category to total loans		
Commercial	\$2,556	17	% \$2,178	19	%	
Real estate	4,574	76	% 5,009	74	%	
Agriculture	228	2	% 203	2	%	
Consumer	220	4	% 426	4	%	
Lease financing receivable	7	1	% 93	1	%	
Total allocated	\$7,585	100	% \$7,909	100	%	

The allocation presented should not be interpreted as an indication that charges to the allowance for loan and lease losses will be incurred in these amounts or proportions, or that the portion of the allowance allocated to each loan and lease category represents the total amounts available for charge-offs that may occur within these categories.

#### Other Real Estate Owned

The balance in OREO at December 31, 2013 consisted of nine properties acquired through foreclosure. The balance in OREO at December 31, 2012 consisted of 20 properties. During 2013, the Company received \$7,517,000 from the net proceeds of the sale of fourteen OREO properties with net gains of \$44,000 in the aggregate recognized on these sales and acquired three properties through foreclosure totaling \$1,829,000 and subsequently reduced that balance by \$229,000 after receiving updated property appraisals or increased that balance by \$187,000 for excess value received or amounts capitalized. There was \$6,726,000 in other real estate owned at December 31, 2013 with a valuation allowance of \$105,000 and \$12,412,000 in other real estate owned at December 31, 2012 with a valuation allowance of \$175,000.

#### Deposits

At December 31, 2013, total deposits were \$483,690,000 representing an increase of \$5,434,000 (1.1%) from the December 31, 2012 balance of \$478,256,000. The Company's deposit growth plan for 2013 was to concentrate its efforts on increasing noninterest-bearing demand, interest-bearing money market and interest-bearing checking, and savings accounts. Due to these efforts, the Company experienced increases during 2013 in interest-bearing checking (\$8,151,000 or 16.0%), money market (\$7,525,000 or 5.9%) and savings (\$194,000 or 0.4%) and decreases in noninterest-bearing demand (\$5,685,000 or 3.8%) and time deposit (\$4,751,000 or 4.9%) accounts.

**Other Borrowed Funds**

Other borrowings outstanding as of December 31, 2013 consist of advances from the Federal Home Loan Bank (the “FHLB”). The following table summarizes these borrowings (dollars in thousands):

	2013		2012		2011	
	Amount	Rate	Amount	Rate	Amount	Rate
Short-term borrowings:						
FHLB advances	\$8,000	2.15 %	\$2,000	0.67 %	\$5,000	2.08 %
Long-term borrowings:						
FHLB advances	\$8,000	1.47 %	\$16,000	1.81 %	\$14,000	1.80 %

The maximum amount of short-term borrowings at any month-end during 2013, 2012 and 2011, was \$8,000,000, \$2,000,000, and \$12,000,000, respectively. The FHLB advances are collateralized by loans and securities pledged to the FHLB. The following is a breakdown of rates and maturities on FHLB advances (dollars in thousands):

	Short-term	Long-term
Amount	\$ 8,000	\$8,000
Maturity	2014	2015 to 2019
Average rates	2.15 %	1.47 %

The Company has also been issued a total of \$5,800,000 as of December 31, 2013 and \$7,500,000 as of December 31, 2012 in letters of credit by the FHLB which have been pledged to secure Local Agency Deposits. The letters of credit act as a guarantee of payment to certain third parties in accordance with specified terms and conditions. The letters of credit were not drawn upon in 2013 or 2012 and management does not expect to draw upon these lines in the foreseeable future.

**Capital Resources**

The current and projected capital position of the Company and the impact of capital plans and long-term strategies are reviewed regularly by management. The Company’s capital position represents the level of capital available to support continuing operations and expansion.

During 2012, the Company approved and authorized a stock repurchase program for 2012 (the “2012 Program”). The 2012 Program authorized the repurchase during 2012 of up to 6% of the outstanding shares of the Company’s common stock, or approximately 593,500 shares. During 2012, the Company repurchased 575,389 shares of its common stock at an average price of \$7.29 per share. On December 20, 2012, the Company approved and authorized a stock repurchase program for 2013 (the “2013 Program”). The 2013 Program authorized the repurchase during 2013 of up to 10% of the outstanding shares of the Company’s common stock, or approximately 932,700 shares based on the 9,327,203 shares outstanding as of December 20, 2012. During 2013, the Company repurchased 894,404 shares of its common stock at an average price of \$8.24 per share. On January 17, 2014, the Company approved and authorized a stock repurchase program for 2014 (the “2014 Program”). The 2014 Program authorized the repurchase during 2014 of up to 5% of the outstanding shares of the Company’s common stock, or approximately 424,462 shares based on the 8,489,247 shares outstanding as of December 20, 2013. Any repurchases under the 2014 Program will be made from time to time by the Company in the open market as conditions allow. All such transactions will be structured to comply with SEC Rule 10b-18 and all shares repurchased under the 2014 Program will be retired. The number, price and timing of the repurchases will be at the Company’s sole discretion and the 2014 Program may be re-evaluated depending on market conditions, capital and liquidity needs or other factors. Based on such re-evaluation, the Board of Directors may suspend, terminate, modify or cancel the 2014 Program at any time without notice.

The Company did not repurchase any shares in 2011, 2010 or 2009. Share amounts have been adjusted for stock dividends and/or splits. See Part II, Item 5, “Stock Repurchases” for more information regarding stock repurchases.

The Company and American River Bank are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation. Failure to meet these 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 Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, banks must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and American River Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

At December 31, 2013, shareholders' equity was \$87,020,000, representing a decrease of \$6,974,000 (7.4%) from \$93,994,000 at December 31, 2012. The decrease results from repurchases of common stock and the decrease in other comprehensive income exceeding the additions from net income for the period and the stock based compensation. In 2012, shareholders' equity decreased \$105,000 (0.1%) from \$94,099,000 at December 31, 2011. The decrease results from repurchases of common stock exceeding the additions from net income for the period, the stock based compensation, and the increase in other comprehensive income. The ratio of total risk-based capital to risk adjusted assets was 23.2% at December 31, 2013 compared to 25.1% at December 31, 2012. Tier 1 risk-based capital to risk-adjusted assets was 22.0% at December 31, 2013 and 23.9% at December 31, 2012.

Table Eleven below lists the Company's actual capital ratios at December 31, 2013 and 2012, as well as the minimum capital ratios for capital adequacy.

**Table Eleven: Capital Ratios**

Capital to Risk-Adjusted Assets	At December 31,		Minimum Regulatory	
	2013	2012	Capital Requirements	
Leverage ratio	11.9 %	12.8 %	4.00	%
Tier 1 Risk-Based Capital	22.0 %	23.9 %	4.00	%
Total Risk-Based Capital	23.2 %	25.1 %	8.00	%

Capital ratios are reviewed on a regular basis to ensure that capital exceeds the prescribed regulatory minimums and is adequate to meet future needs. American River Bank's ratios are in excess of the regulatory definition of "well capitalized." Management believes that the Company's capital is adequate to support current operations and anticipated growth and currently foreseeable future capital requirements of the Company and its subsidiaries.

In July 2013, the federal bank regulatory agencies issued interim final rules that revise and replace the current risk-based capital requirements in order to implement the "Basel III" regulatory capital reforms released by the Basel Committee on Banking Supervision and changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The Basel III reforms reflected in the final rules include an increase in the risk-based capital requirements and certain changes to capital components and the calculation of risk-weighted assets.

Effective January 1, 2015, banking organizations like the Company and American River Bank must comply with new minimum capital ratio requirements to be phased-in between January 1, 2015 and January 1, 2019, which would consist of the following: (i) a new common equity Tier 1 capital to total risk weighted assets ratio of 4.5%; (ii) a Tier 1 capital to total risk weighted assets ratio of 6% (increased from 4%); (iii) a total capital to total risk weighted assets ratio of 8% (unchanged from current rules); and (iv) a Tier 1 capital to adjusted average total assets ("leverage") ratio of 4%.

The interim final rules also established (i) a “capital conservation buffer,” to be phased in between January 2016 and January 2019, which would require maintenance of a minimum of 2.5% in excess of the regulatory minimum capital ratio requirements described above; and (ii) an increase in the capital ratios to qualify as “well capitalized” under prompt corrective action regulations effective January 1, 2015, which require a new common equity Tier 1 capital ratio of 6.5%, a Tier 1 capital ratio of 8% (increased from 6%), a total capital ratio of 10% (unchanged from current rules) and a Tier 1 leverage ratio of 5% (increased from 4%).

## Market Risk Management

*Overview.* Market risk is the risk of loss from adverse changes in market prices and rates. The Company's market risk arises primarily from interest rate risk inherent in its loan and deposit functions. The goal for managing the assets and liabilities of the Company is to maximize shareholder value and earnings while maintaining a high quality balance sheet without exposing the Company to undue interest rate risk. The Board of Directors has overall responsibility for the interest rate risk management policies. The Company has a Risk Management Committee that establishes and monitors guidelines to control the sensitivity of earnings to changes in interest rates.

*Overview.* Market risk is the risk of loss from adverse changes in market prices and rates. The Company's market risk arises primarily from interest rate risk inherent in its loan, investment and deposit functions. The goal for managing the assets and liabilities of the Company is to maximize shareholder value and earnings while maintaining a high quality balance sheet without exposing the Company to undue interest rate risk. The Board of Directors has overall responsibility for the interest rate risk management policies. The Company has an Enterprise Risk Management Committee, made up of Company management that establishes and monitors guidelines to control the sensitivity of earnings to changes in interest rates.

*Asset/Liability Management.* Activities involved in asset/liability management include but are not limited to lending, accepting and placing deposits and investing in securities. Interest rate risk is the primary market risk associated with asset/liability management. Sensitivity of earnings to interest rate changes arises when yields on assets change in a different time period or in a different amount from that of interest costs on liabilities. To mitigate interest rate risk, the structure of the balance sheet is managed with the goal that movements of interest rates on assets and liabilities are correlated and contribute to earnings even in periods of volatile interest rates. The asset/liability management policy sets limits on the acceptable amount of variance in net interest margin and market value of equity under changing interest environments. The Company uses simulation models to forecast earnings, net interest margin and market value of equity.

Simulation of earnings is the primary tool used to measure the sensitivity of earnings to interest rate changes. Using computer-modeling techniques, with specialized software built for this specific purpose for financial institutions, the Company is able to estimate the potential impact of changing interest rates on earnings, net interest margin and market value of equity. A balance sheet is prepared using detailed inputs of actual loans, securities and interest-bearing liabilities (i.e. deposits/borrowings). The balance sheet is processed using multiple interest rate scenarios. The scenarios include a rising rate forecast, a flat rate forecast and a falling rate forecast which take place within a one-year time frame. The net interest income is measured over a one and a two year periods assuming a gradual change in rates over the twelve-month horizon. The simulation modeling attempts to estimate changes in the Company's net interest income utilizing a detailed current balance sheet.

After a review of the model results as of December 31, 2013, the Company does not consider the fluctuations from the base case, to have a material impact on the Company's projected results and are within the tolerance levels outlined in the Company's interest rate risk polices. The simulations of earnings do not incorporate any management actions, which might moderate the negative consequences of interest rate deviations. Therefore, they do not reflect likely actual results, but serve as reasonable estimates of interest rate risk.

## *Interest Rate Sensitivity Analysis*

Interest rate sensitivity is a function of the repricing characteristics of the portfolio of assets and liabilities. These repricing characteristics are the time frames within which the interest-bearing assets and liabilities are subject to change in interest rates either at replacement, repricing or maturity. Interest rate sensitivity management focuses on the maturity of assets and liabilities and their repricing during periods of changes in market interest rates. Interest rate sensitivity is measured as the difference between the volumes of assets and liabilities in the current portfolio that are subject to repricing at various time horizons. The differences are known as interest sensitivity gaps. A positive cumulative gap may be equated to an asset sensitive position. An asset sensitive position in a rising interest rate environment will cause a bank's interest rate margin to expand. This results as floating or variable rate loans reprice more rapidly than fixed rate certificates of deposit that reprice as they mature over time. Conversely, a declining interest rate environment will cause the opposite effect. A negative cumulative gap may be equated to a liability sensitive position. A liability sensitive position in a rising interest rate environment will cause a bank's interest rate margin to contract, while a declining interest rate environment will have the opposite effect.



## Inflation

The impact of inflation on a financial institution differs significantly from that exerted on manufacturing, or other commercial concerns, primarily because its assets and liabilities are largely monetary. In general, inflation primarily affects the Company through its effect on market rates of interest, which affects the Company's ability to attract loan customers. Inflation affects the growth of total assets by increasing the level of loan demand, and potentially adversely affects capital adequacy because loan growth in inflationary periods can increase at rates higher than the rate that capital grows through retention of earnings which may be generated in the future. In addition to its effects on interest rates, inflation increases overall operating expenses. Inflation has not had a material effect upon the results of operations of the Company during the years ended December 31, 2013, 2012 and 2011.

## Liquidity

Liquidity management refers to the Company's ability to provide funds on an ongoing basis to meet fluctuations in deposit levels as well as the credit needs and requirements of its clients. Both assets and liabilities contribute to the Company's liquidity position. Federal funds lines, short-term investments and securities, and loan and lease repayments contribute to liquidity, along with deposit increases, while loan and lease funding and deposit withdrawals decrease liquidity. The Company assesses the likelihood of projected funding requirements by reviewing historical funding patterns, current and forecasted economic conditions and individual client funding needs. Commitments to fund loans and outstanding standby letters of credit at December 31, 2013 were approximately \$31,681,000 and \$6,363,000, respectively. Such loan commitments relate primarily to revolving lines of credit and other commercial loans and to real estate construction loans. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The Company's sources of liquidity consist of cash and due from correspondent banks, overnight funds sold to correspondent banks, unpledged marketable investments and loans held for sale. On December 31, 2013, consolidated liquid assets totaled \$221.6 million or 37.4% of total assets compared to \$216.5 million or 36.2% of total assets on December 31, 2012. In addition to liquid assets, the Company maintains short-term lines of credit in the amount of \$17,000,000 with two of its correspondent banks. At December 31, 2013, the Company had \$17,000,000 available under these credit lines. Additionally, American River Bank is a member of the FHLB. At December 31, 2013, American River Bank could have arranged for up to \$78,030,000 in secured borrowings from the FHLB. These borrowings are secured by pledged mortgage loans and investment securities. At December 31, 2013, the Company had \$56,230,000 available under these secured borrowing arrangements. American River Bank also has a secured borrowing arrangement with the Federal Reserve Bank. The borrowing can be secured by pledging selected loans and investment securities. Based on the amount of assets pledged at the Federal Reserve Bank at December 31, 2013, the Company's borrowing capacity was \$21,358,000.

The Company serves primarily a business and professional customer base and, as such, its deposit base is susceptible to economic fluctuations. Accordingly, management strives to maintain a balanced position of liquid assets to volatile and cyclical deposits.

Liquidity is also affected by portfolio maturities and the effect of interest rate fluctuations on the marketability of both assets and liabilities. The Company can sell any of its unpledged securities held in the available-for-sale category to meet liquidity needs. These securities are also available to pledge as collateral for borrowings if the need should arise. American River Bank can also pledge additional securities to borrow from the Federal Reserve Bank and the FHLB.

The maturity distribution of certificates of deposit is set forth in Table Thirteen below for the period presented. These deposits are generally more rate sensitive than other deposits and, therefore, are more likely to be withdrawn to obtain higher yields elsewhere if available.

**Table Thirteen: Certificates of Deposit Maturities**

December 31, 2013		
(dollars in thousands)	Less than \$100,000	Over \$100,000
Three months or less	\$ 6,129	\$ 29,222
Over three months through six months	4,156	12,116
Over six months through twelve months	5,669	5,237
Over twelve months	7,286	22,415
Total	\$ 23,240	\$ 68,990

Loan and lease demand also affects the Company's liquidity position. Table Fourteen below presents the maturities of loans and leases for the period indicated.

**Table Fourteen: Loan and Lease Maturities (Gross Loans and Leases)**

December 31, 2013				
(dollars in thousands)	One year or less	One year through five years	Over five years	Total
Commercial	\$ 6,555	\$ 16,351	\$ 1,639	\$24,545
Real estate	20,725	76,361	125,539	222,625
Agriculture	410	835	1,875	3,120
Consumer	248	5,007	517	5,772
Leases	59	1,285	—	1,344
Total	\$ 27,997	\$ 99,839	\$ 129,570	\$257,406

Loans and leases shown above with maturities greater than one year include \$162,785,000 of floating interest rate loans and \$66,624,000 of fixed rate loans and leases.

The carrying amount, maturity distribution and weighted average yield of the Company's investment securities available-for-sale and held-to-maturity portfolios are presented in Table Fifteen below. The yields on tax-exempt obligations have been computed on a tax equivalent basis. Yields may not represent actual future income to be recorded. Timing of principal prepayments on mortgage-backed securities may increase or decrease depending on market factors and the borrowers' ability to make unscheduled principal payments. Fast prepayments on bonds that were purchased with a premium will result in a lower yield and slower prepayments on premium bonds will result in a higher yield, the opposite would be true for bonds purchased at a discount. Table Fifteen does not include FHLB Stock, which does not have stated maturity dates or readily available market values. The balance in FHLB Stock at December 31, 2013, 2012 and 2011 was \$3,248,000, \$3,254,000 and \$3,093,000, respectively.

**Table Fifteen: Securities Maturities and Weighted Average Yields  
December 31,**

(Taxable Equivalent Basis)

(dollars in thousands)	2013 Carrying Amount	Weighted Average Yield	Carrying Amount	2012 Weighted Average Yield	Carrying Amount	2011 Weighted Average Yield		
Available-for-sale securities:								
State and political subdivisions								
Maturing within 1 year	\$346	7.54	% \$911	6.04	% \$833	5.69	%	
Maturing after 1 year but within 5 years	2,357	4.98	% 1,787	5.20	% 2,675	6.08	%	
Maturing after 5 years but within 10 years	12,067	4.72	% 11,940	4.35	% 10,139	5.93	%	
Maturing after 10 years	12,133	4.14	% 15,018	4.55	% 15,541	5.26	%	
Mortgage-backed securities	244,160	2.09	% 200,515	2.06	% 179,454	2.54	%	
Other								
Maturing after 1 year but within 5 years	1,609	4.88	% 1,594	4.88	% —	—	%	
Non-maturing	119	0.00	% 74	0.00	% 69	0.00	%	
Total investment securities	\$272,791	2.34	% \$231,839	2.54	% \$208,711	2.45	%	
Held-to-maturity securities:								
Mortgage-backed securities	\$1,185	4.54	% \$2,117	4.52	% \$4,010	4.50	%	
Total investment securities	\$1,185	4.57	% \$2,117	4.52	% \$4,010	4.50	%	

The carrying values of available-for-sale securities include net unrealized gains of \$1,872,000, \$7,142,000 and \$5,930,000 at December 31, 2013, 2012 and 2011, respectively. The carrying values of held-to-maturity securities do not include unrealized gains or losses; however, the net unrecognized gains at December 31, 2013, 2012 and 2011 were \$78,000, \$138,000 and \$221,000, respectively.

**Off-Balance Sheet Arrangements**

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheet.

As of December 31, 2013, commitments to extend credit and letters of credit were the only financial instruments with off-balance sheet risk. The Company has not entered into any contracts for financial derivative instruments such as futures, swaps, options or similar instruments. At origination, real estate commitments are generally secured by property with a loan-to-value ratio of 55% to 75%. In addition, the majority of the Company's commitments have variable interest rates. The following financial instruments represent off-balance-sheet credit risk:

December 31,  
2013      2012

Commitments to extend credit (dollars in thousands):

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Revolving lines of credit secured by 1-4 family residences	\$2,071	\$3,644
Commercial real estate, construction and land development commitments secured by real estate	11,890	7,587
Other unused commitments, principally commercial loans	17,720	15,287
	\$31,681	\$26,518
Letters of credit	\$6,363	\$6,506

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The Company's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and letters of credit as it does for loans included on the consolidated balance sheets.

Certain financial institutions have elected to use special purpose vehicles ("SPV") to dispose of problem assets. The SPV is typically a subsidiary company with an asset and liability structure and legal status that makes its obligations secure even if the parent corporation goes bankrupt. Under certain circumstances, these financial institutions may exclude the problem assets from their reported impaired and non-performing assets. The Company does not use those vehicles or any other structures to dispose of problem assets.

### Contractual Obligations

The Company leases certain facilities at which it conducts its operations. Future minimum lease commitments under non-cancelable operating leases are noted in Table Sixteen below. Table Sixteen below presents certain of the Company's contractual obligations as of December 31, 2013. Included in the table are amounts payable under the Company's Deferred Compensation Plan, Deferred Fees Plan and salary continuation agreements listed in the "Other Long-Term Liabilities..." category. At December 31, 2013, these amounts represented \$3,451,000 most of which is anticipated to be primarily payable at least five years in the future.

#### Table Sixteen: Contractual Obligations

(dollars in thousands)	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt	\$16,000	\$8,000	\$4,000	\$2,000	\$2,000
Capital Lease Obligations	—	—	—	—	—
Operating Leases	2,787	775	1,387	516	109
Purchase Obligations	—	—	—	—	—
Certificates of Deposit	92,230	62,529	14,367	15,319	15
Other Long-Term Liabilities Reflected on the Company's Balance Sheet under GAAP	3,451	152	329	183	2,787
Total	\$114,468	\$71,456	\$20,083	\$18,018	\$4,911

### Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board amended existing guidance related to reporting amounts reclassified out of other comprehensive income out of accumulated other comprehensive income. These amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. These amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. Generally Accepted Accounting Principles ("GAAP") to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional details about those amounts. These amendments are effective prospectively for interim and annual reporting periods beginning after December 15, 2012. The effect of adopting this standard did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.



Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

The information required by Item 7A of Form 10-K is contained in the “Market Risk Management” section of Item 7-“Management’s Discussion and Analysis of Financial Condition and Results of Operations” on page 55.

**Item 8. Financial Statements and Supplementary Data.**

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All schedules have been omitted since the required information is not present in amounts sufficient to require submission of the schedule or because the information required is included in the Consolidated Financial Statements or notes thereto.



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Shareholders and Board of Directors

American River Bankshares

Rancho Cordova, California

We have audited the accompanying consolidated balance sheets of American River Bankshares and subsidiaries (the "Company") as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive (loss) income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company'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 Company 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 Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of American River Bankshares and subsidiaries as of December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

/s/ Crowe Horwath LLP

Sacramento, California

February 27, 2014

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**AMERICAN RIVER BANKSHARES AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****December 31, 2013 and 2012****(Dollars in thousands)**

	2013	2012
<b>ASSETS</b>		
Cash and due from banks	\$17,948	\$55,461
Interest-bearing deposits in banks	1,000	750
Investment securities (Note 5):		
Available-for-sale, at fair value	272,791	231,839
Held-to-maturity, at amortized cost	1,185	2,117
Loans and leases, less allowance for loan and lease losses of \$5,346 in 2013 and \$5,781 in 2012 (Notes 6, 7, 12 and 17)	251,747	252,118
Premises and equipment, net (Note 8)	1,500	1,888
Federal Home Loan Bank of San Francisco stock	3,248	3,254
Other real estate owned, net	6,621	12,237
Goodwill (Note 4)	16,321	16,321
Bank-owned life insurance (Note 16)	12,686	12,858
Accrued interest receivable and other assets (Notes 11 and 16)	7,706	7,546
	<b>\$592,753</b>	<b>\$596,389</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits:		
Noninterest-bearing	\$145,516	\$151,201
Interest-bearing (Note 9)	338,174	327,055
Total deposits	483,690	478,256
Short-term borrowings (Note 10)	8,000	2,000
Long-term borrowings (Note 10)	8,000	16,000
Accrued interest payable and other liabilities (Note 16)	6,043	6,139
Total liabilities	505,733	502,395
Commitments and contingencies (Note 12)		
Shareholders' equity (Notes 13 and 14):		
Common stock - no par value; 20,000,000 shares authorized; issued and outstanding –8,489,247 shares in 2013 and 9,327,203 shares in 2012	61,108	67,977
Retained earnings	24,789	21,732
Accumulated other comprehensive income, net of taxes (Note 5)	1,123	4,285

Total shareholders' equity	87,020	93,994
	\$592,753	\$596,389
See accompanying notes to consolidated financial statements.		

**AMERICAN RIVER BANKSHARES AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****For the Years Ended December 31, 2013, 2012 and 2011****(Dollars in thousands, except per share data)**

	2013	2012	2011
Interest income:			
Interest and fees on loans and leases	\$ 14,191	\$ 16,687	\$ 19,235
Interest on deposits in banks	3	8	20
Interest and dividends on investment securities:			
Taxable	3,822	3,708	4,224
Exempt from Federal income taxes	865	896	720
Total interest income	18,881	21,299	24,199
Interest expense:			
Interest on deposits (Note 9)	1,197	1,610	2,238
Interest on borrowings	293	284	370
Total interest expense	1,490	1,894	2,608
Net interest income	17,391	19,405	21,591
Provision for loan and lease losses (Note 7)	200	1,365	3,625
Net interest income after provision for loan and lease losses	17,191	18,040	17,966
Noninterest income:			
Service charges	590	724	761
Gain on sale and call of investment securities (Note 5)	36	93	353
Other income (Note 15)	1,389	1,957	994
Total noninterest income	2,015	2,774	2,108
Noninterest expense:			
Salaries and employee benefits (Notes 6 and 16)	8,516	8,260	8,465
Other real estate expense	936	2,065	1,288
Occupancy (Notes 8, 12 and 17)	1,212	1,209	1,140
Furniture and equipment (Notes 8 and 12)	758	812	719
Regulatory assessments	382	633	931
Other expense (Notes 4 and 15)	3,087	3,768	3,758
Total noninterest expense	14,891	16,747	16,301
Income before provision for income taxes	4,315	4,067	3,773
Provision for income taxes (Note 11)	1,258	860	1,269

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Net income	\$3,057	\$3,207	\$2,504
Basic earnings per share (Note 13)	\$0.34	\$0.34	\$0.25
Diluted earnings per share (Note 13)	\$0.34	\$0.34	\$0.25
Cash dividends per share of issued and outstanding common stock	\$—	\$—	\$—

See accompanying notes to consolidated financial statements.

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**AMERICAN RIVER BANKSHARES AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME****For the Years Ended December 31, 2013, 2012 and 2011****(Dollars in thousands)**

	2013	2012	2011
Net income	\$3,057	\$3,207	\$2,504
Other comprehensive (loss) income:			
Increase in net unrealized (losses) gains on investment securities	(5,234)	1,305	3,435
Deferred tax benefit (expense)	2,094	(522 )	(1,374)
(Decrease) increase in net unrealized gains on investment securities, net of tax	(3,140)	783	2,061
Reclassification adjustment for realized gains included in net income	(36 )	(93 )	(353 )
Tax effect	14	37	141
Realized gains, net of tax	(22 )	(56 )	(212 )
Total other comprehensive (loss) income	(3,162)	727	1,849
Comprehensive (loss) income	\$(105 )	\$3,934	\$4,353
See accompanying notes to consolidated financial statements.			

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

For the Years Ended December 31, 2013, 2012 and 2011

(Dollars in thousands)

	Common Stock		Retained	Accumulated Other Comprehensive Income (Net of Taxes)	Total Share- holders' Equity
	Shares	Amount	Earnings		
Balance, January 1, 2011	9,874,867	\$71,814	\$ 16,021	\$ 1,709	\$89,544
Net income	—	—	2,504	—	2,504
Other comprehensive income, net of tax: Net change in unrealized gains on available-for-sale investment securities (Note 5)	—	—	—	1,849	1,849
Net restricted stock award activity and related compensation expense	16,042	86	—	—	86
Stock option compensation expense	—	116	—	—	116
Balance, December 31, 2011	9,890,909	72,016	18,525	3,558	94,099
Net income	—	—	3,207	—	3,207
Other comprehensive income, net of tax: Net change in unrealized gains on available-for-sale investment securities (Note 5)	—	—	—	727	727
Retirement of common stock (Note 13)	(575,389 )	(4,194 )	—	—	(4,194 )
Net restricted stock award activity and related compensation expense	11,683	110	—	—	110
Stock option compensation expense	—	45	—	—	45
Balance, December 31, 2012	9,327,203	67,977	21,732	4,285	93,994
Net income	—	—	3,057	—	3,057
Other comprehensive loss, net of tax: Net change in unrealized gains on available-for-sale investment securities (Note 5)	—	—	—	(3,162 )	(3,162 )
Retirement of common stock (Note 13)	(849,404 )	(7,000 )	—	—	(7,000 )
Net restricted stock award activity and related compensation expense	11,448	111	—	—	111
Stock option compensation expense	—	20	—	—	20

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Balance, December 31, 2013	8,489,247	\$61,108	\$24,789	\$ 1,123	\$87,020
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See accompanying notes to consolidated financial statements.

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**AMERICAN RIVER BANKSHARES AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****For the Years Ended December 31, 2013, 2012 and 2011****(Dollars in thousands)**

	2013	2012	2011
Cash flows from operating activities:			
Net income	\$3,057	\$3,207	\$2,504
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan and lease losses	200	1,365	3,625
Increase (decrease) in deferred loan and lease origination fees, net	83	(72 )	(125 )
Depreciation and amortization	518	784	739
Amortization of investment security premiums and discounts, net	5,774	4,333	2,484
Gain on sale and call of investment securities	(36 )	(93 )	(353 )
Increase in cash surrender value of life insurance policies	(129 )	(1,566 )	(273 )
Gain on life insurance death benefit	(118 )	—	—
Provision for deferred income taxes	244	454	(438 )
Stock-based compensation expense	131	155	202
Gain or loss on sale/write-down of other real estate owned	158	1,571	1,319
Decrease in accrued interest receivable and other assets	1,703	128	265
(Decrease) increase in accrued interest payable and other liabilities	(96 )	5	(1,140 )
Net cash provided by operating activities	11,489	10,271	8,809
Cash flows from investing activities:			
Proceeds from the sale of available-for-sale investment securities	8,851	15,567	9,706
Proceeds from called available-for-sale investment securities	590	195	1,365
Proceeds from matured available-for-sale investment securities	905	825	430
Purchases of available-for-sale investment securities	(119,972)	(96,475)	(93,208)
Proceeds from principal repayments for available-for-sale mortgage-backed securities	57,664	53,727	28,445
Proceeds from principal repayments for held-to-maturity mortgage-backed securities	934	1,898	2,156
Net (increase) decrease in interest-bearing deposits in banks	(250 )	500	998
Net (increase) decrease in loans and leases	(1,741 )	31,066	32,784
Net proceeds from sale of other real estate owned	7,475	3,637	1,705
Death benefit from life insurance policy	419	—	—
Capitalized additions to other real estate	(187 )	—	—
Purchases of equipment	(130 )	(134 )	(849 )
Net decrease (increase) in FHLB stock	6	(161 )	393
Net cash (used in) provided by investing activities	(45,436 )	10,645	(16,075)
(Continued)			



**AMERICAN RIVER BANKSHARES AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Continued)

**For the Years Ended December 31, 2013, 2012 and 2011****(Dollars in thousands)**

	2013	2012	2011
Cash flows from financing activities:			
Net increase in demand, interest-bearing and savings deposits	\$ 10,185	\$ 16,713	\$ 9,678
Net decrease in time deposits	(4,751 )	(742 )	(12,515 )
Cash paid to repurchase common stock	(7,000 )	(4,194 )	—
(Decrease) increase in long-term borrowings	(8,000 )	2,000	4,000
Increase (decrease) in short-term borrowings	6,000	(3,000 )	(2,000 )
Net cash (used in) provided by financing activities	(3,566 )	10,777	(837 )
(Decrease) increase in cash and cash equivalents	(37,513)	31,693	(8,103 )
Cash and cash equivalents at beginning of year	55,461	23,768	31,871
Cash and cash equivalents at end of year	\$ 17,948	\$ 55,461	\$ 23,768
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest expense	\$ 1,490	\$ 1,958	\$ 2,650
Income taxes	\$ 1,575	\$ 1,395	\$ 1,250
Non-cash investing activities:			
Real estate acquired through foreclosure	\$ 1,829	\$ 9,388	\$ 9,489

See accompanying notes to consolidated financial statements.

## **AMERICAN RIVER BANKSHARES AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

#### **1. THE BUSINESS OF THE COMPANY**

American River Bankshares (the “Company”) was incorporated under the laws of the State of California in 1995 under the name of American River Holdings and changed its name in 2004 to American River Bankshares. As a bank holding company, the Company is authorized to engage in the activities permitted under the Bank Holding Company Act of 1956, as amended, and regulations thereunder. As a community oriented regional bank holding company, the principal communities served are located in Sacramento, Placer, Yolo, El Dorado, Amador, and Sonoma counties. In addition, the Company has two loan production offices located in Alameda and Santa Clara counties.

The Company owns 100% of the issued and outstanding common shares of its banking subsidiary, American River Bank (“ARB” or the “Bank”). ARB was incorporated in 1983. ARB accepts checking and savings deposits, offers money market deposit accounts and certificates of deposit, makes secured and unsecured commercial, secured real estate, and other installment and term loans and offers other customary banking services. ARB operates four banking offices in Sacramento County, one banking office in Placer County, two banking offices in Sonoma County, and three banking offices in Amador County. The Company also owns one inactive subsidiary, American River Financial.

ARB does not offer trust services or international banking services and does not plan to do so in the near future. The deposits of ARB are insured by the Federal Deposit Insurance Corporation (the “FDIC”) up to applicable legal limits.

#### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

##### General

The accounting and reporting policies of the Company and its subsidiaries conform with accounting principles generally accepted in the United States of America and prevailing practices within the financial services industry.

##### Reclassifications

Certain reclassifications have been made to prior years’ balances to conform to classifications used in 2013. Reclassifications had no effect on prior year net income or shareholders’ equity.

### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany transactions and accounts have been eliminated in consolidation.

### Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The allowance for loan and lease losses and fair values of financial instruments are particularly subject to change.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

**2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Cash and Cash Equivalents

For the purpose of the statement of cash flows, cash and due from banks and Federal funds sold are considered to be cash equivalents. Generally, Federal funds are sold for one-day periods.

Interest-Bearing Deposits in Banks

Interest-bearing deposits in banks mature within one year and are carried at cost.

Investment Securities

Investments are classified into the following categories:

Available-for-sale securities, reported at fair value, with unrealized gains and losses excluded from earnings and reported, net of taxes, as accumulated other comprehensive income (loss) within shareholders' equity.

Held-to-maturity securities, which management has the positive intent and ability to hold to maturity, reported at amortized cost, adjusted for the accretion of discounts and amortization of premiums.

Management determines the appropriate classification of its investments at the time of purchase and may only change the classification in certain limited circumstances. All transfers between categories are accounted for at fair value. There were no transfers during the years ended December 31, 2013 and 2012.

Gains or losses on the sale of investment securities are computed on the specific identification method. Interest earned on investment securities is reported in interest income, net of applicable adjustments for accretion of discounts and amortization of premiums.

An investment security is impaired when its carrying value is greater than its fair value. Investment securities that are impaired are evaluated on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline and the intent and ability of the Company to retain its investment in the securities for a period of time sufficient to allow for an anticipated recovery in fair value, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term “other than temporary” is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not necessarily favorable, or that there is a lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. For debt securities, once a decline in value is determined to be other than temporary and management does not intend to sell the security or it is more likely than not that management will not be required to sell the security before recovery, only the portion of the impairment loss representing credit exposure is recognized as a charge to earnings, with the balance recognized as a charge to other comprehensive income. If management intends to sell the security or it is more likely than not that management will be required to sell the security before recovering its forecasted cost, the entire impairment loss is recognized as a charge to earnings. For equity securities, the entire amount of impairment is recognized through earnings.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

**2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Federal Home Loan Bank Stock

Investments in Federal Home Loan Bank of San Francisco (the “FHLB”) stock are carried at cost and are redeemable at par with certain restrictions. Investments in FHLB stock are necessary to participate in FHLB programs.

Loans and Leases

Loans and leases that management has both the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal amounts outstanding, adjusted for unearned income, deferred loan origination fees and costs, purchase premiums and discounts, write-downs and the allowance for loan and lease losses. Loan and lease origination fees, net of certain deferred origination costs, and purchase premiums and discounts are recognized as an adjustment to the yield of the related loans and leases.

For all classes of loans and leases, the accrual of interest is discontinued when, in the opinion of management, there is an indication that the borrower may be unable to meet payment requirements within an acceptable time frame relative to the terms stated in the loan agreement. Upon such discontinuance, all unpaid accrued interest is reversed against current income unless the loan or lease is well secured and in the process of collection. Interest received on nonaccrual loans and leases is either applied against principal or reported as interest income, according to management’s judgment as to the collectability of principal. Generally, loans and leases are restored to accrual status when the obligation is brought current and has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Direct financing leases are carried net of unearned income. Income from leases is recognized by a method that approximates a level yield on the outstanding net investment in the lease.

Loan Sales and Servicing



Included in the loan and lease portfolio are Small Business Administration (“SBA”) loans and Farm Service Agency guaranteed loans that may be sold in the secondary market. At the time the loan is sold, the related right to service the loan is either retained, with the Company earning future servicing income, or released in exchange for a one-time servicing-released premium. Loans subsequently transferred to the loan portfolio are transferred at the lower of cost or fair value at the date of transfer. Any difference between the carrying amount of the loan and its outstanding principal balance is recognized as an adjustment to yield by the interest method. There were no loans held for sale at December 31, 2013 and 2012.

SBA and Farm Service Agency loans with unpaid balances of \$269,000 and \$328,000 were being serviced for others as of December 31, 2013 and 2012, respectively. The Company also serviced loans that are participated with other financial institutions totaling \$8,320,000 and \$10,108,000 as of December 31, 2013 and 2012, respectively.

Servicing rights acquired through 1) a purchase or 2) the origination of loans which are sold or securitized with servicing rights retained are recognized as separate assets or liabilities. Servicing assets or liabilities are initially recorded at fair value and are subsequently amortized in proportion to and over the period of the related net servicing income or expense. Servicing assets are periodically evaluated for impairment. Servicing assets were not considered material for disclosure purposes at December 31, 2013 and 2012.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

**2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Allowance for Loan and Lease Losses

The allowance for loan and lease losses is an estimate of probable credit losses inherent in the Company's credit portfolio that have been incurred as of the balance-sheet date. The allowance is established through a provision for loan and lease losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after credit losses and loan growth. Credit exposures determined to be uncollectible are charged against the allowance. Cash received on previously charged off amounts is typically recorded as a recovery to the allowance. The overall allowance consists of two primary components, specific reserves related to impaired credits and general reserves for inherent probable losses related to credits that are not impaired.

For all classes of the portfolio, a loan or lease is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the original agreement. Impaired loans are individually evaluated to determine the extent of impairment, if any, except for smaller-balance loans that are collectively evaluated for credit risk. When a loan or lease is impaired, the Company measures impairment based on the present value of expected future cash flows discounted at the credit's original interest rate, except that as a practical expedient, it may measure impairment based on a credit's observable market price, or the fair value of the collateral if the credit is collateral dependent. A loan or lease is collateral dependent if the repayment of the credit is expected to be provided solely by the sale or operation of the underlying collateral.

For all portfolio segments, a restructuring of a debt constitutes a troubled debt restructuring ("TDR") if the Company grants a concession to the borrower for economic or legal reasons related to the borrower's financial difficulties that it would not otherwise consider. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans or leases that are reported as TDRs are considered impaired and measured for impairment as described above.

For all portfolio segments, the determination of the general reserve for loans and leases that are not impaired is based on estimates made by management, to include, but not limited to, consideration of historical losses by portfolio segment, internal asset classifications, and qualitative factors to include economic trends in the Company's service areas, industry experience and trends, geographic concentrations, estimated collateral values, the Company's underwriting policies, the character of the credit portfolio, and probable losses inherent in the portfolio taken as a

whole.

The Company determines a separate allowance for each portfolio segment. These portfolio segments include commercial, real estate construction (including land and development loans), residential real estate, multi-family real estate, commercial real estate, leases, agriculture and consumer loans. The allowance for loan and lease losses attributable to each portfolio segment, which includes both impaired credits and credits that are not impaired, is combined to determine the Company's overall allowance, which is included as a component of loans and leases on the consolidated balance sheet and available for all loss exposures.

The Company assigns a risk rating to all loans and periodically performs detailed reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by independent specialists engaged by the Company and the Company's regulators. During the internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which borrowers operate and the fair values of collateral securing these loans. These credit quality indicators are used to assign a risk rating to each individual credit. The risk ratings can be grouped into six major categories, defined as follows:

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AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Allowance for Loan and Lease Losses (Continued)

**Pass** – A pass loan is a strong credit with no existing or known potential weaknesses deserving of management’s close attention.

**Watch** – A watch credit is a loan or lease that otherwise meets the definition of a standard or minimum acceptable quality loan, but which requires more than normal attention due to any of the following items: deterioration of borrower financial condition less severe than those warranting more adverse grading, deterioration of repayment ability and/or collateral value, increased leverage, adverse effects from a downturn in the economy, local market or industry, adverse changes in local or regional employer, management changes (including illness, disability, and death), and adverse legal action. Payments are current per the terms of the agreement. If conditions persist or worsen, a more severe risk grade may be warranted.

**Special Mention** – A special mention credit is a loan or lease that has potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the credit or in the Company’s position at some future date. Special Mention credits are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

**Substandard** – A substandard credit is a loan or lease that is not adequately protected by the current sound worth and paying capacity of the borrower or the value of the collateral pledged, if any. Credits classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Well defined weaknesses include inadequate cash flow or collateral support, a project’s lack of marketability, failure to complete construction on time or a project’s failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

**Doubtful** – Credits classified as doubtful are loans or leases that have all the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

**Loss** – Credits classified as loss are loans or leases considered uncollectible and charged off immediately.

The general reserve component of the allowance for loan and lease losses also consists of reserve factors that are based on management's assessment of the following for each portfolio segment: (1) inherent credit risk, (2) historical losses and (3) other qualitative factors. These reserve factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment described below.

**Real Estate- Commercial** – Commercial real estate mortgage loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except land and construction loans. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for properties to produce sufficient cash flow to service debt obligations.

**Real Estate- Construction** – These loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within specified cost and time lines. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

Allowance for Loan and Lease Losses (Continued)

***Real Estate- Multi-family*** – Multi-family loans are non-construction term mortgages for the acquisition, refinance, or improvement of residential rental properties with generally more than 4 dwelling units. Underwriting is generally based on borrower creditworthiness, sufficiency of net operating income to service the bank loan payment, and a prudent loan-to-value ratio, among other factors.

***Real Estate- Residential*** – Residential loans are generally loans to purchase or refinance 1-4 unit single-family residences, either owner-occupied or investor-owned. Some residential loans are short term to match their intended source of repayment through sale or refinance. The remainder are fixed or floating-rate term first mortgages with an original maturity between 2 and 10 years, generally with payments based on a 25-30 year amortization.

***Commercial*** – Commercial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

***Lease Financing Receivable*** – Leases originated by the bank are non-consumer finance leases (as contrasted with operating leases) for the acquisition of titled and non-titled business equipment. Leases are generally amortized over a period from 36 to 84 months, depending on the useful life of the equipment acquired. Residual (balloon) payments at lease end range from 0-20% of original cost, and are a non-optional obligation of the lessee. Lessees are contractually responsible for all costs, expenses, taxes, and liability associated with the leased equipment.

***Agricultural*** – Loans secured by crop production and livestock are especially vulnerable to two risk factors that are largely outside the control of the Company and borrowers: commodity prices and weather conditions.

**Consumer** – The consumer loan portfolio is comprised of a large number of small loans scheduled to be amortized over a specific period. Most installment loans are made directly for consumer purchases, but business loans granted for the purchase of heavy equipment or industrial vehicles may also be included. Also included in the consumer loan portfolio are home equity lines of credit. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be adequate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the adequacy of the allowance, including consideration of the relative risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Company's primary regulators, the FDIC and the California Department of Business Oversight, as an integral part of their examination process, review the adequacy of the allowance. These regulatory agencies may require additions to the allowance based on their judgment about information available at the time of their examinations.

#### Allowance for Credit Losses on Off-Balance-Sheet Credit Exposures

The Company also maintains a separate allowance for off-balance-sheet commitments. Management estimates probable incurred losses using historical data and utilization assumptions. The allowance for off-balance-sheet commitments is included in accrued interest payable and other liabilities on the consolidated balance sheet.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

**2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Other Real Estate Owned (OREO)

Other real estate owned includes real estate acquired in full or partial settlement of loan obligations. When property is acquired, any excess of the recorded investment in the loan balance and accrued interest income over the estimated fair market value of the property less estimated selling costs is charged against the allowance for loan and lease losses. A valuation allowance for losses on other real estate may be maintained to provide for temporary declines in value. The valuation allowance is established through a provision for losses on other real estate which is included in other expenses. Subsequent gains or losses on sales or writedowns resulting from permanent impairments are recorded in other income or expense as incurred. During 2013, the Company received \$7,475,000 in net proceeds from the sale of other real estate owned with net gains of \$44,000 recognized on the sale. During 2012, the Company received \$3,637,000 in net proceeds from the sale of other real estate owned with net losses of \$2,000 recognized on the sale. The recorded investment in other real estate owned totaled \$6,621,000 and \$12,237,000 at December 31, 2013 and 2012, respectively, and had related valuation allowances of \$106,000 and \$175,000, respectively.

Premises and Equipment

Premises and equipment are carried at cost. Depreciation is determined using the straight-line method over the estimated useful lives of the related assets. The useful life of the building and improvements is forty years. The useful lives of furniture, fixtures and equipment are estimated to be three to ten years. Leasehold improvements are amortized over the life of the asset or the term of the related lease, whichever is shorter. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred. Impairment of long-lived assets is evaluated by management based upon an event or changes in circumstances surrounding the underlying assets which indicate long-lived assets may be impaired.

Goodwill and Intangible Assets



Business combinations involving the Company's acquisition of equity interests or net assets of another enterprise or the assumption of net liabilities in an acquisition of branches constituting a business may give rise to goodwill. Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. The value of goodwill is ultimately derived from the Company's ability to generate net earnings after the acquisition and is not deductible for tax purposes. A decline in net earnings could be indicative of a decline in the fair value of goodwill and result in impairment. For that reason, goodwill is assessed for impairment at least annually. Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value. At December 31, 2013, the Company had one reporting unit and that reporting unit had positive equity and the Company elected to perform a qualitative assessment to determine if it was more likely than not that the fair value of the reporting unit exceeded its carrying value, including goodwill. The qualitative assessment indicated that it was more likely than not that the fair value of the reporting unit exceeded its carrying value, resulting in no impairment.

Intangible assets are comprised of core deposit intangibles which represent the estimated fair value of the long-term deposit relationships that were assumed when the Company acquired Bank of Amador in December 2004. Core deposit intangibles are amortized over a period that approximates the expected run-off of the deposit base, which, in this case, is eight years. The intangible asset related to the Bank of Amador acquisition became fully amortized during 2012.

#### Bank-Owned Life Insurance

The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

**2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Income Taxes

The Company files its income taxes on a consolidated basis with its subsidiaries. The allocation of income tax expense represents each entity's proportionate share of the consolidated provision for income taxes.

The Company accounts for income taxes using the balance sheet method, under which deferred tax assets and liabilities are recognized for the tax consequences of temporary differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment. The deferred provision for income taxes is the result of the net change in the deferred tax asset and deferred tax liability balances during the year. This amount combined with the current taxes payable or refundable, results in the income tax expense for the current year. On the consolidated balance sheet, net deferred tax assets are included in accrued interest receivable and other assets.

The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax assets will not be realized. "More likely than not" is defined as greater than a 50% chance. All available evidence, both positive and negative is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. Based upon the Company's analysis of available evidence, the Company determined that it is "more likely than not" that all of the deferred income tax assets as of December 31, 2013 and 2012 will be fully realized and therefore no valuation allowance was recorded.

The Company uses a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. Interest expense and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the consolidated statement of income.

Comprehensive Income

Comprehensive income is reported in addition to net income for all periods presented. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of other comprehensive income (loss) that historically has not been recognized in the calculation of net income. Unrealized gains and losses on the Company's available-for-sale investment securities are included in other comprehensive income (loss), adjusted for realized gains or losses included in net income. Total comprehensive income and the components of accumulated other comprehensive income (loss) are presented in the consolidated statements of comprehensive income.

### Earnings Per Share

Basic earnings per share ("EPS"), which excludes dilution, is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock, such as stock options or restricted stock, result in the issuance of common stock that share in the earnings of the Company. The treasury stock method has been applied to determine the dilutive effect of stock options and restricted stock in computing diluted EPS. Earnings and dividends per share are restated for all stock splits and stock dividends through the date of issuance of the consolidated financial statements. There were no stock splits or stock dividends in 2013, 2012 or 2011.

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)Stock-Based Compensation

At December 31, 2013, the Company had two stock-based compensation plans, which are described more fully in Note 13. Compensation expense, net of related tax benefits, recorded in 2013, 2012 and 2011 totaled \$84,000, \$102,000 and \$180,000, or \$0.01, \$0.01 and \$0.02 per diluted share, respectively. Compensation expense is recognized over the vesting period on a straight line accounting basis.

The fair value of each option award is estimated on the date of grant using a Black-Scholes-Merton based option valuation model that uses the assumptions noted in the following table. Because Black-Scholes-Merton based option valuation models incorporate ranges of assumptions for inputs, those ranges are disclosed. Expected volatilities are based on historical volatility of the Company's stock and other factors. The Company uses historical data to estimate the dividend yield, option life and forfeiture rate within the valuation model. The expected option life represents the period of time that options granted are expected to be outstanding. The risk-free rate for the period representing the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	2012
Dividend yield	0.0 %
Expected volatility	28.8 %
Risk-free interest rate	1.19 %
Expected option life in years	7
Weighted average fair value of options granted during the year	\$2.31

There were no options granted in 2013 or 2011 under either stock-based compensation plans.

Restricted stock awards are grants of shares of the Company's common stock that are subject to forfeiture until specific conditions or goals are met. Conditions may be based on continuing employment or service and/or achieving specified performance goals. During the period of restriction, Plan participants holding restricted share awards have voting and cash dividend rights. The restrictions lapse in accordance with a schedule or with other conditions determined by the Board of Directors as reflected in each award agreement. Upon the vesting of each restricted stock award, the Company issues the associated common shares from its inventory of authorized common shares. All outstanding

awards under the Plan immediately vest in the event of a change of control of the Company. The shares associated with any awards that fail to vest become available for re-issuance under the Plan.

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 2.SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock-Based Compensation (Continued)

The following is a summary of stock-based compensation information as of or for the years ended December 31, 2013, 2012 and 2011:

	2013	2012	2011
	(Dollars in thousands)		
Total intrinsic value of options exercised	\$—	\$—	\$—
Aggregate cash received for option exercises	\$—	\$—	\$—
Total fair value of options vested	\$40	\$90	\$178
Total compensation cost, options and restricted stock	\$131	\$155	\$202
Tax benefit recognized	\$47	\$53	\$22
Net compensation cost, options and restricted stock	\$84	\$102	\$180
Total compensation cost for nonvested option awards not yet recognized	\$38	\$59	\$62
Weighted average years for compensation cost for nonvested options to be recognized	1.1	1.1	.8
Total compensation cost for restricted stock not yet recognized	\$173	\$152	\$151
Weighted average years for compensation cost for restricted stock to be recognized	1.0	1.4	1.6

Operating Segments

While the chief decision-makers monitor the revenue streams of the various products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Operating segments are aggregated into one as operating results for all segments are similar. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable operating segment.

Adoption of New Accounting Standards

In February 2013, the Financial Accounting Standards Board amended existing guidance related to reporting amounts reclassified out of other comprehensive income out of accumulated other comprehensive income. These amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. These amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. Generally Accepted Accounting Principles (“GAAP”) to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional details about those amounts. These amendments are effective prospectively for interim and annual reporting periods beginning after December 15, 2012. The effect of adopting this standard did not have a material effect on the Company’s consolidated financial position, results of operations or cash flows.

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**3. FAIR VALUE MEASUREMENTS**

The following tables present information about the Company's assets and liabilities measured at fair value on a recurring and nonrecurring basis as of December 31, 2013 and December 31, 2012. They indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

Estimated fair values are disclosed for financial instruments for which it is practicable to estimate fair value. These estimates are made at a specific point in time based on relevant market data and information about the financial instruments. These estimates do not reflect any premium or discount that could result from offering the Company's entire holdings of a particular financial instrument for sale at one time, nor do they attempt to estimate the value of anticipated future business related to the instruments. In addition, the tax ramifications related to the realization of unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The carrying amounts and estimated fair values of the Company's financial instruments are as follows (dollars in thousands):

December 31, 2013	Carrying Amount	Fair Value Measurements Using:			Total
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and due from banks	\$17,948	\$17,948			\$17,948
Interest-bearing deposits in banks	1,000		1,000		1,000
Available-for-sale securities	272,791	70	272,721		272,791



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Held-to-maturity securities	1,185		1,263		1,263
FHLB stock	3,248	N/A	N/A	N/A	N/A
Loans and leases, net	251,747			249,931	249,931
Accrued interest receivable	1,930		1,170	760	1,930

Financial liabilities:

Deposits:

Noninterest-bearing	\$145,516	\$145,516			\$145,516
Savings	51,733	51,733			51,733
Money market	135,169	135,169			135,169
NOW accounts	59,042	59,042			59,042
Time, \$100,000 or more	68,990		69,763		69,763
Other time	23,240		23,426		23,426
Short-term borrowings	8,000	8,000			8,000
Long-term borrowings	8,000		8,110		8,110
Accrued interest payable	125		125		125

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 3. FAIR VALUE MEASUREMENTS (Continued)

December 31, 2012	Carrying Amount	Fair Value Measurements Using:			Total
		Level 1	Level 2	Level 3	
Financial assets:					
Cash and due from banks	\$55,461	\$55,461			\$55,461
Interest-bearing deposits in banks	750		750		750
Available-for-sale securities	231,839	15	231,824		231,839
Held-to-maturity securities	2,117		2,255		2,255
FHLB stock	3,254	N/A	N/A	N/A	N/A
Loans and leases, net	252,118			253,455	253,455
Accrued interest receivable	1,872		1,044	828	1,872
Financial liabilities:					
Deposits:					
Noninterest-bearing	\$151,201	\$151,201			\$151,201
Savings	51,539	51,539			51,539
Money market	127,644	127,644			127,644
NOW accounts	50,891	50,891			50,891
Time, \$100,000 or more	71,145		71,904		71,904
Other time	25,836		26,068		26,068
Short-term borrowings	2,000	2,000			2,000
Long-term borrowings	16,000		16,147		16,147
Accrued interest payable	162		162		162

Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the fair values presented.

The following methods and assumptions were used by the Company to estimate the fair values of its financial instruments at December 31, 2013 and December 31, 2012:

Cash and due from banks: The carrying amounts of cash and short-term instruments approximate fair values and are classified as Level 1.

Interest-bearing deposits in banks: The fair values of interest-bearing deposits in banks are estimated by discounting their future cash flows using rates at each reporting date for instruments with similar remaining maturities offered by comparable financial institutions and are classified as Level 2.

Investment securities: For investment securities, fair values are based on quoted market prices, where available, and are classified as Level 1. If quoted market prices are not available, fair values are estimated using quoted market prices for similar securities and indications of value provided by brokers and are classified as Level 2.

FHLB stock: It is not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability.

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**3. FAIR VALUE MEASUREMENTS (Continued)**

Loans and leases: Fair values of loans, excluding loans held for sale, are estimated as follows: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality also resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

Deposits: The fair values disclosed for demand deposits (e.g. interest and non-interest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amount) resulting in a Level 1 classification. For time deposits, the fair values for fixed rate certificates of deposit are estimated using a discounted cash flow methodology that applies market interest rates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Short-term and long-term borrowings: The fair value of short-term borrowings is estimated to be the carrying amount and is classified as Level 1. The fair value of long-term borrowings is estimated using a discounted cash flow analysis using interest rates currently available for similar debt instruments and are classified as Level 2.

Accrued interest receivable and payable: The carrying amount of accrued interest receivable and accrued interest payable approximates fair value resulting in a Level 2 or 3 classification consistent with the asset or liability it is associated with..

Off-balance sheet instruments: Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The fair value of commitments was not material at December 31, 2013 and December 31, 2012.

Assets and liabilities measured at fair value on a recurring and non-recurring basis are presented in the following table:

(dollars in thousands)

		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
December 31, 2013	Fair Value				
Assets and liabilities measured on a recurring basis:					
Available-for-sale securities:					
Mortgage-backed securities	\$ 244,160	\$ —	\$ 244,160	\$ —	\$ —

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Corporate Debt Securities	1,609		1,609			
Obligations of states and political subdivisions	26,903		26,903		—	—
Corporate stock	119	70	49		—	—
Total recurring	\$ 272,791	\$ 70	\$ 272,721	\$	—	\$ —
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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 3. FAIR VALUE MEASUREMENTS (Continued)

(dollars in thousands)		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	Total Gains (Losses)
December 31, 2013	Fair Value	(Level 1)	(Level 2)	(Level 3)	(Losses)
Assets and liabilities measured on a nonrecurring basis:					
Impaired loans:					
Real estate:					
Commercial	306			306	6
Other real estate owned	6,621			6,621	(250 )
Total nonrecurring	\$ 6,927	\$	\$	\$ 6,927	\$ (244 )

(dollars in thousands)		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	Total Gains (Losses)
December 31, 2012	Fair Value	(Level 1)	(Level 2)	(Level 3)	(Losses)
Assets and liabilities measured on a recurring basis:					
Available-for-sale securities:					
Mortgage-backed securities	\$ 200,515	\$ —	\$ 200,515	\$ —	\$ —
Corporate Debt Securities	1,594		1,594		

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Obligations of states and political subdivisions	29,656		29,656	—	—
Corporate stock	74	15	59	—	—
Total recurring	\$ 231,839	\$ 15	\$ 231,824	\$ —	\$ —
Assets and liabilities measured on a nonrecurring basis:					
Impaired loans:					
Commercial	\$ 776	\$	\$	\$ 776	\$ (106 )
Real estate:					
Commercial	432			432	(68 )
Residential	210			210	(72 )
Other real estate owned	12,237			12,237	(1,002 )
Total nonrecurring	\$ 13,655	\$	\$	\$ 13,655	\$ (1,248 )

There were no transfers between Levels 1 and 2 during the years ended December 31, 2013 or December 31, 2012.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

**3. FAIR VALUE MEASUREMENTS (Continued)**

The following methods were used to estimate the fair value of each class of financial instrument above:

Available-for-sale securities – Fair values for investment securities are based on quoted market prices, if available, and are considered Level 1, or evaluated using pricing models that vary by asset class and incorporate available trade, bid and other market information and are considered Level 2. Pricing applications apply available information, as applicable, through processes such as benchmark curves, benchmarking to like securities, sector groupings and matrix pricing.

Impaired loans – The fair value of collateral dependent impaired loans adjusted for specific allocations of the allowance for loan losses is generally based on recent real estate appraisals and/or evaluations. These appraisals and/or evaluations may utilize a single valuation approach or a combination of approaches including comparable sales, cost and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income and other available data. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. The valuation technique used for all Level 3 nonrecurring impaired loans is the sales comparison approach less a reserve for past dues taxes and selling costs ranging from 8% to 10%.

Other real estate owned – Certain commercial and residential real estate properties classified as OREO are measured at fair value, less costs to sell. Fair values are based on recent real estate appraisals and/or evaluations. These appraisals and/or evaluations may use a single valuation approach or a combination of approaches including comparable sales, cost and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income and other available data. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. The valuation technique used for all Level 3 nonrecurring OREO is the sales comparison approach less selling costs ranging from 8% to 10%.

**4. GOODWILL AND OTHER INTANGIBLE ASSETS**

At December 31, 2013 and 2012, goodwill totaled \$16,321,000. Goodwill is evaluated annually for impairment and was most recently evaluated in December 2012 under the provisions of the codification Topic 350, *Goodwill and*



*Other Intangibles.* Management determined that no impairment recognition was required for the years ended December 31, 2013, 2012 and 2011.

Amortization of the intangible assets included in other expense totaled \$183,000 for the year ended December 31, 2012 and \$219,000 for the year ended December 31, 2011. The December 31, 2011 balance of \$183,000 was fully amortized in 2012.

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 5. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities at December 31, 2013 and 2012 consisted of the following (dollars in thousands):

Available-for-Sale

	2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities	\$243,058	\$ 3,429	\$ (2,327 )	\$244,160
Obligations of states and political subdivisions	26,302	775	(174 )	26,903
Corporate Debt Securities	1,505	104	—	1,609
Equity securities:				
Corporate stock	54	65	—	119
	\$270,919	\$ 4,373	\$ (2,501 )	\$272,791
	2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities	\$195,444	\$ 5,661	\$ (590 )	\$200,515
Obligations of states and political subdivisions	27,682	1,974	—	29,656
Corporate Debt Securities	1,507	87	—	1,594
Equity securities:				
Corporate stock	64	10	—	74

\$224,697 \$ 7,732 \$ (590 ) \$231,839

Net unrealized gains on available-for-sale investment securities totaling \$1,872,000 were recorded, net of \$749,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2013.

Proceeds and gross realized gains from the sale, impairment and call of available-for-sale investment securities for the year ended December 31, 2013 totaled \$9,441,000 and \$36,000, respectively. There were no transfers of available-for-sale investment securities during the year ended December 31, 2013.

Net unrealized gains on available-for-sale investment securities totaling \$7,142,000 were recorded, net of \$2,857,000 in tax liabilities, as accumulated other comprehensive income within shareholders' equity at December 31, 2012.

Proceeds and gross realized gains from the sale and call of available-for-sale investment securities for the year ended December 31, 2012 totaled \$15,762,000 and \$93,000, respectively. There were no transfers of available-for-sale investment securities during the year ended December 31, 2012.

Proceeds and gross realized gains from the sale and call of available-for-sale investment securities for the year ended December 31, 2011 totaled \$11,071,000 and \$353,000, respectively.

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 5. INVESTMENT SECURITIES (Continued)

Held-to-Maturity

	2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities	\$1,185	\$ 78	\$ —	\$ 1,263

	2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:				
Mortgage-backed securities	\$2,117	\$ 138	\$ —	\$ 2,255

There were no sales or transfers of held-to-maturity investment securities for the years ended December 31, 2013, 2012 and 2011.

The amortized cost and estimated fair value of investment securities at December 31, 2013 by contractual maturity are shown below (dollars in thousands).

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year	\$345	\$346		
After one year through five years	3,801	3,966		
After five years through ten years	11,641	12,067		

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After ten years	12,020	12,133		
Investment securities not due at a single maturity date:				
Mortgage-backed securities	243,058	244,160	\$ 1,185	\$ 1,263
Corporate stock	54	119		
	\$270,919	\$272,791	\$ 1,185	\$ 1,263

Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

Investment securities with amortized costs totaling \$61,319,000 and \$43,877,000 and estimated fair values totaling \$62,440,000 and \$45,877,000 were pledged to secure State Treasury funds on deposit, public agency and bankruptcy trustee deposits and borrowing arrangements (see Note 10) at December 31, 2013 and 2012, respectively.

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 5. INVESTMENT SECURITIES (Continued)

Investment securities with unrealized losses at December 31, 2013 and 2012 are summarized and classified according to the duration of the loss period as follows (dollars in thousands):

	2013					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>Available-for-Sale</u>						
Debt securities:						
Mortgage-backed securities	\$10,047	\$ (147 )	\$98,723	\$ (2,180 )	\$108,770	\$ (2,327 )
Obligations of states and political subdivisions	4,223	(174 )	—	—	4,223	(174 )
	\$14,270	\$ (321 )	\$98,723	\$ (2,180 )	\$112,993	\$ (2,501 )
	2012					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>Available-for-Sale</u>						
Debt securities:						
U.S. Government guaranteed and sponsored entity mortgage-backed securities	\$37,440	\$ (590 )	\$ —	\$ —	\$37,440	\$ (590 )

At December 31, 2013, the Company held 216 securities of which 49 were in a loss position for less than twelve months and five were in a loss position for twelve months or more. Of these securities 44 are mortgage-backed securities and five are obligations of states and political subdivisions.

The unrealized loss on the Company's investments in mortgage-backed securities is primarily driven by interest rates. Because the decline in market value is attributable to a change in interest rates and not credit quality, and because the Company has the ability and intent to hold these investments until recovery of fair value, which may be maturity, management does not consider these investments to be other-than-temporarily impaired.

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**6. LOANS AND LEASES**

Outstanding loans and leases are summarized as follows (dollars in thousands):

	December 31,	
	2013	2012
Real estate – commercial	\$ 184,204	\$ 180,126
Real estate – construction	9,633	6,918
Real estate – multi-family	11,085	9,155
Real estate – residential	17,703	17,701
Commercial	24,545	30,811
Lease financing receivable	1,344	1,509
Agriculture	3,120	3,340
Consumer	5,772	8,569
	257,406	258,129
Deferred loan and lease origination fees, net	(313 )	(230 )
Allowance for loan and lease losses	(5,346 )	(5,781 )
	\$ 251,747	\$ 252,118

Certain loans are pledged as collateral for available borrowings with the FHLB and the Federal Reserve Bank of San Francisco (the “FRB”). Pledged loans totaled \$140,604,000 and \$162,657,000 at December 31, 2013 and 2012, respectively (see [Note 10](#)).

The components of the Company’s lease financing receivable are summarized as follows (dollars in thousands):

	December 31,	
	2013	2012
Future lease payments receivable	\$ 1,396	\$ 1,585
Residual interests	38	39



Unearned income (90 ) (115 )

Net lease financing receivable \$1,344 \$1,509

Future lease payments receivable are as follows (dollars in thousands):

Year Ending  
December 31,

2014	\$ 540
2015	469
2016	236
2017	95
2018	56
Total lease payments receivable	\$ 1,396

Salaries and employee benefits totaling \$315,000, \$339,000 and \$371,000 have been deferred as loan and lease origination costs for the years ended December 31, 2013, 2012 and 2011, respectively.

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**7.ALLOWANCE FOR LOAN AND LEASE LOSSES**

Changes in the allowance for loan and lease losses were as follows (dollars in thousands):

	Year Ended December 31,		
	2013	2012	2011
Balance, beginning of year	\$5,781	\$7,041	\$7,585
Provision charged to operations	200	1,365	3,625
Losses charged to allowance	(938 )	(2,854)	(4,698)
Recoveries	303	229	529
Balance, end of year	\$5,346	\$5,781	\$7,041

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

The following tables show the activity in the allowance for loan and lease losses for the years ended December 31, 2013, 2012 and 2011 and the allocation of the allowance for loan and lease losses as of December 31, 2013 and 2012 by portfolio segment and by impairment methodology (dollars in thousands):

	December 31, 2013										
	Real Estate		Other			Agriculture		Consumer		Unallocated	Total
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases					
Allowance for Loan and Lease Losses											
Beginning balance	\$ 1,351	\$ 2,526	\$ 238	\$ 594	\$ 477	\$ 3	\$ 87	\$ 262	\$ 243	\$ 5,781	
Provision for loan losses	(304 )	327	4	(73 )	363	2	(7 )	(75 )	(37 )	200	
Loans charged-off	(377 )	(476 )	—	—	(58 )	(1 )	—	(26 )	—	(938 )	
Recoveries	215	24	—	21	43	—	—	—	—	303	
Ending balance allocated to portfolio segments	\$ 885	\$ 2,401	\$ 242	\$ 542	\$ 825	\$ 4	\$ 80	\$ 161	\$ 206	\$ 5,346	
Ending balance: Individually evaluated for impairment	\$ 392	\$ 792	\$ 108	\$	\$ 276	\$	\$	\$ 30	\$	\$ 1,598	
Ending balance:	\$ 493	\$ 1,609	\$ 134	\$ 542	\$ 549	\$ 4	\$ 80	\$ 131	\$ 206	\$ 3,748	

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Collectively  
evaluated for  
impairment

Loans

Ending balance	\$24,545	\$184,204	\$11,085	\$9,633	\$17,703	\$1,344	\$3,120	\$5,772	\$	\$257,406
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Ending  
balance:

Individually evaluated for impairment	\$1,736	\$19,919	\$1,650	\$248	\$3,316	\$	\$	\$165	\$	\$27,034
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Ending  
balance:

Collectively evaluated for impairment	\$22,809	\$164,285	\$9,435	\$9,385	\$14,387	\$1,344	\$3,120	\$5,607	\$	\$230,372
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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

	December 31, 2012									
	Commercial	Real Estate Commercial	Multi-Family	Construction	Residential	Other Leases	Agriculture	Consumer	Unallocated	Total
Allowance for Loan and Lease Losses										
Beginning balance	\$ 1,536	\$ 3,156	\$ 198	\$ 582	\$ 609	\$ 79	\$ 167	\$ 348	\$ 366	\$ 7,041
Provision for loan losses	96	347	45	367	35	(73 )	282	389	(123 )	1,365
Loans charged-off	(302 )	(1,124 )	(8 )	(377 )	(167 )	(9 )	(362 )	(505 )	—	(2,854 )
Recoveries	21	147	3	22	—	6	—	30	—	229
Ending balance allocated to portfolio segments	\$ 1,351	\$ 2,526	\$ 238	\$ 594	\$ 477	\$ 3	\$ 87	\$ 262	\$ 243	\$ 5,781
Ending balance: Individually evaluated for impairment	\$ 480	\$ 786	\$ 122	\$	\$ 179	\$	\$	\$ 28	\$	\$ 1,595
Ending balance: Collectively evaluated for impairment	\$ 871	\$ 1,740	\$ 116	\$ 594	\$ 298	\$ 3	\$ 87	\$ 234	\$ 243	\$ 4,186
Loans										

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Ending balance	\$30,811	\$180,126	\$9,155	\$6,918	\$17,701	\$1,509	\$3,340	\$8,569	\$	\$258,129
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Ending balance: Individually evaluated for impairment	\$2,828	\$19,105	\$1,681	\$263	\$2,429	\$	\$	\$247	\$	\$26,553
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Ending balance: Collectively evaluated for impairment	\$27,983	\$161,021	\$7,474	\$6,655	\$15,272	\$1,509	\$3,340	\$8,322	\$	\$231,576
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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

	December 31, 2011									
	Real Estate			Other						
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	Unallocated	Total
Allowance for Loan and Lease Losses										
Beginning balance	\$2,574	\$2,715	\$ 115	\$ 1,090	\$ 581	\$7	\$ 131	\$ 221	\$ 151	\$7,585
Provision for loan losses	(488 )	2,341	203	327	593	72	35	327	215	3,625
Loans charged-off	(713 )	(2,005)	(120 )	(835 )	(565 )	—	(240 )	(220 )	—	(4,698)
Recoveries	163	105	—	—	—	—	241	20	—	529
Ending balance allocated to portfolio segments	\$1,536	\$3,156	\$ 198	\$ 582	\$ 609	\$79	\$ 167	\$ 348	\$ 366	\$7,041

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

The following tables show the loan portfolio allocated by management's internal risk ratings as of December 31, 2013 and 2012 (dollars in thousands):

December 31, 2013

Credit Risk Profile by Internally Assigned Grade

Grade:	Real Estate				Other Credit Exposure				Total
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	
Pass	\$20,728	\$147,995	\$9,509	\$5,778	\$11,706	\$1,344	\$2,728	\$5,486	\$205,274
Watch	1,556	12,567	1,156	3,270	2,530	—	—	21	21,100
Special mention	491	19,253	420	585	1,281	—	392	111	22,533
Substandard	1,770	4,389	—	—	2,186	—	—	154	8,499
Doubtful	—	—	—	—	—	—	—	—	—
Total	\$24,545	\$184,204	\$11,085	\$9,633	\$17,703	\$1,344	\$3,120	\$5,772	\$257,406

December 31, 2012

Credit Risk Profile by Internally Assigned Grade

Grade:	Real Estate				Other Credit Exposure				Total
	Commercial	Commercial	Multi-Family	Construction	Residential	Leases	Agriculture	Consumer	
Pass	\$25,670	\$134,969	\$7,018	\$3,049	\$13,283	\$1,506	\$2,938	\$7,696	\$196,129
Watch	1,994	14,613	1,181	3,262	2,518	—	—	251	23,819
Special mention	653	16,041	441	607	1,163	—	402	153	19,460
Substandard	1,804	14,503	515	—	737	3	—	469	18,031
Doubtful	690	—	—	—	—	—	—	—	690
Total	\$30,811	\$180,126	\$9,155	\$6,918	\$17,701	\$1,509	\$3,340	\$8,569	\$258,129





## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

The following tables show an aging analysis of the loan portfolio at December 31, 2013 and 2012 (dollars in thousands):

	December 31, 2013			Total Past Due	Current	Total Loans	Past Due Greater Than 90 Days and Accruing	Nonaccrual
	30-59 Days Past Due	60-89 Days Past Due	Past Due Greater Than 90 Days					
Commercial:								
Commercial	\$	\$	\$ 798	\$ 798	\$ 23,747	\$ 24,545	\$	\$ 766
Real estate:								
Commercial	1,598	336	713	2,647	181,557	184,204	80	977
Multi-family					11,085	11,085		
Construction					9,633	9,633		
Residential					17,703	17,703		
Other:								
Leases					1,344	1,344		
Agriculture					3,120	3,120		
Consumer	25	1	90	116	5,656	5,772		156
Total	\$ 1,623	\$ 337	\$ 1,601	\$ 3,561	\$ 253,845	\$ 257,406	\$ 80	\$ 1,899

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 7.ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

	December 31, 2012		Past Due Greater Than 90 Days	Total Past Due	Current	Total Loans	Past Due Greater Than 90 Days and Accruing	Nonaccrual
	30-59 Days Past Due	60-89 Days Past Due						
Commercial:								
Commercial	\$804	\$	\$ 1,497	\$ 2,301	\$28,510	\$ 30,811	\$	\$ 2,352
Real estate:								
Commercial		703	700	1,403	178,723	180,126		2,687
Multi-family					9,155	9,155		
Construction					6,918	6,918		
Residential			210	210	17,491	17,701		210
Other:								
Leases			3	3	1,506	1,509		3
Agriculture					3,340	3,340		
Consumer		60	114	174	8,395	8,569		222
Total	\$804	\$ 763	\$ 2,524	\$ 4,091	\$ 254,038	\$ 258,129	\$	\$ 5,474

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

The following tables show information related to impaired loans as of and for the years ended December 31, 2013, 2012 and 2011 (dollars in thousands):

	December 31, 2013			Average Recorded Investment	Interest Income Recognized
	Recorded Investment	Unpaid Principal Balance	Related Allowance		
With no related allowance recorded:					
Commercial	\$577	\$577	\$ —	\$ 665	\$ 11
Real estate:					
Commercial	10,921	11,119	—	11,614	11
Construction	248	248	—	256	—
Other:					
Consumer	37	37	—	37	1
	\$11,783	\$11,981	\$ —	\$ 12,572	\$ 23
With an allowance recorded:					
Commercial	\$1,159	\$1,159	\$ 392	\$ 1,240	\$ 10
Real estate:					
Commercial	8,998	8,998	792	9,008	196
Multi-family	1,650	1,743	108	1,665	39
Residential	3,316	3,316	276	3,354	70
Other:					
Consumer	128	128	30	136	1
	\$15,251	\$15,344	\$ 1,598	\$ 15,403	\$ 316
Total:					
Commercial	\$1,736	\$1,736	\$ 392	\$ 1,905	\$ 21
Real estate:					
Commercial	19,919	20,117	792	20,622	207
Multi-family	1,650	1,743	108	1,665	39

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Construction	248	248	—	256	
Residential	3,316	3,316	276	3,354	70
Other:					
Consumer	165	165	30	173	2
	\$27,034	\$27,325	\$ 1,598	\$ 27,975	\$ 339

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

	December 31, 2012				
	Recorded	Unpaid Principal InvestmenBalance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	\$ 1,248	\$ 1,407	\$ —	\$ 593	\$ 1
Real estate:					
Commercial	10,882	11,603	—	7,803	185
Multi-family	—	—	—	9	—
Construction	263	263	—	131	—
Residential	—	—	—	90	—
Other:					
Leases	—	—	—	9	—
Consumer	37	109	—	85	1
	\$ 12,430	\$ 13,382	\$ —	\$ 8,720	\$ 187
With an allowance recorded:					
Commercial	\$ 1,580	\$ 1,580	\$ 480	\$ 1,817	\$ 50
Real estate:					
Commercial	8,223	8,287	786	10,863	215
Multi-family	1,681	1,774	122	1,434	44
Construction	—	—	—	1,042	—
Residential	2,429	2,483	179	2,183	52
Other:					
Agriculture	—	—	—	299	—
Consumer	210	210	28	398	4
	\$ 14,123	\$ 14,334	\$ 1,595	\$ 18,036	\$ 365
Total:					
Commercial	\$ 2,828	\$ 2,987	\$ 480	\$ 2,410	\$ 51
Real estate:					
Commercial	19,105	19,890	786	18,666	400
Multi-family	1,681	1,774	122	1,443	44

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Construction	263	263	—	1,173	—
Residential	2,429	2,483	179	2,273	52
Other:					
Leases	—	—	—	9	—
Agriculture	—	—	—	299	—
Consumer	247	319	28	483	5
	\$26,553	\$27,716	\$ 1,595	\$ 26,756	\$ 552

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 7. ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)

	December 31, 2011				
	Recorded	Unpaid Principal InvestmenBalance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Commercial	\$3,069	\$3,089	—	\$ 3,880	\$ 166
Real estate:					
Commercial	4,723	6,428	—	4,830	185
Multi-family	17	17	—	19	2
Residential	180	180	—	182	12
Other:					
Leases	17	17	—	21	1
Consumer	133	133	—	142	10
	\$8,139	\$9,864	\$ —	\$ 9,074	\$ 376
With an allowance recorded:					
Commercial	\$2,054	\$3,705	\$ 538	\$ 2,404	\$ 37
Real estate:					
Commercial	13,504	13,853	707	13,898	609
Multi-family	1,187	1,280	5	1,200	42
Construction	2,083	2,402	147	2,222	19
Residential	1,936	1,936	118	1,973	93
Other:					
Agriculture	597	597	89	598	3
Consumer	585	585	76	587	31
	\$21,946	\$24,358	\$ 1,680	\$ 22,882	\$ 834
Total:					
Commercial	\$5,123	\$6,794	\$ 538	\$ 6,284	\$ 203
Real estate:					
Commercial	18,227	20,281	707	18,728	794
Multi-family	1,204	1,297	5	1,219	44
Construction	2,083	2,402	147	2,222	19



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Residential	2,116	2,116	118	2,155	105
Other:					
Leases	17	17		21	1
Agriculture	597	597	89	598	3
Consumer	718	718	76	729	41
	\$30,085	\$34,222	\$ 1,680	\$ 31,956	\$ 1,210

The recorded investment in loans and leases that were considered to be impaired totaled \$27,034,000 at December 31, 2013 and had a related valuation allowance of \$1,589,000. The average recorded investment in impaired loans and leases during 2013 was approximately \$27,975,000.

The recorded investment in loans and leases that were considered to be impaired totaled \$26,553,000 at December 31, 2012 and had a related valuation allowance of \$1,595,000. The average recorded investment in impaired loans and leases during 2012 was approximately \$26,756,000.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

**7.ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)**

Non-accrual loans and leases totaled approximately \$1,899,000 and \$5,474,000 at December 31, 2013 and 2012, respectively. There was a single loan of approximately \$80,000 that was in the process of renewal that was past due 90 days and accruing interest at December 31, 2013 and no loans and leases past due 90 days or more and still accruing interest at December 31, 2012. Interest income on non-accrual loans is generally recognized on a cash basis and was approximately \$161,000, \$197,000 and \$440,000 for the years ended December 31, 2013, 2012 and 2011. Interest foregone on non-accrual loans was approximately \$327,000, \$715,000 and \$1,706,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

Troubled Debt Restructurings

At December 31, 2013 and 2012, the Company had \$13,207,000 and \$17,367,000 in loans to clients whose loan terms were modified in troubled debt restructurings, respectively. The Company had allocated \$817,000 and \$1,575,000 of specific reserves to these troubled debt restructurings as of December 31, 2013 and 2012, respectively. The Company has not committed to lend additional amounts as of December 31, 2013 and 2012 to borrowers with outstanding loans that are classified as troubled debt restructurings.

During the period ended December 31, 2013, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan at a stated rate of interest lower than the current market rate for new debt with similar risk; an extension of the maturity date; or a term out of a revolving loan.

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from one month to eight years. Modifications involving an extension of the maturity date were for periods ranging from six months to eight years.

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The following table presents loans by class modified as troubled debt restructurings during the year ended December 31, 2013 (dollars in thousands):

	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial	3	\$ 352	\$ 352
Real estate – commercial	8	6,989	6,989
Real estate – residential	1	564	564
Total	12	\$ 7,905	\$ 7,905

The troubled debt restructurings described above increased the allowance for loan and lease losses by \$89,000 and resulted in no charge offs of during the year ended December 31, 2013.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the year ended December 31, 2013 (dollars in thousands):

	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Commercial	1	\$ 474
Total	1	\$ 474

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**7.ALLOWANCE FOR LOAN AND LEASE LOSSES (Continued)**Troubled Debt Restructurings (Continued)

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

The troubled debt restructurings that subsequently defaulted described above increased the allowance for loan and lease losses by \$229,000 and resulted in no charge-offs during the year ended December 31, 2013.

The following table presents loans by class modified as troubled debt restructurings during the year ended December 31, 2012 (dollars in thousands):

	Number of Loans	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial	8	\$ 1,589	\$ 1,589
Real estate – commercial	9	4,676	4,638
Real estate – multi-family	2	539	539
Real estate – residential	4	942	829
Other – agriculture	1	410	410
Other – consumer	4	50	50
Total	28	\$ 8,206	\$ 8,055

The troubled debt restructurings described above increased the allowance for loan and lease losses by \$430,000 and resulted in charge-offs of \$211,000 during the year ended December 31, 2012.

The following table presents loans by class modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the year ended December 31, 2012 (dollars in thousands):

	Number of Loans	Recorded Investment
Troubled debt restructurings that subsequently defaulted:		
Real estate – commercial	2	\$ 1,097
Other – agriculture	2	215
Total	4	\$ 1,312

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**7. ALLOWANCE FOR LOAN AND LEASE LOSSES** (Continued)Troubled Debt Restructurings (Continued)

The troubled debt restructurings that subsequently defaulted described above increased the allowance for loan and lease losses by \$18,000 and resulted in charge-offs of \$485,000 during the year ended December 31, 2012.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting policy.

**8. PREMISES AND EQUIPMENT**

Premises and equipment consisted of the following (dollars in thousands):

	December 31,	
	2013	2012
Land	\$206	\$206
Building and improvements	802	769
Furniture, fixtures and equipment	5,681	5,587
Leasehold improvements	1,647	1,646
	8,336	8,208
Less accumulated depreciation and amortization	(6,836)	(6,320)
	\$1,500	\$1,888

Depreciation and amortization included in occupancy and furniture and equipment expense totaled \$518,000, \$601,000 and \$520,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

**9.INTEREST-BEARING DEPOSITS**

Interest-bearing deposits consisted of the following (dollars in thousands):

	December 31,	
	2013	2012
Savings	\$51,733	\$51,539
Money market	135,169	127,644
NOW accounts	59,042	50,891
Time, \$100,000 or more	68,990	71,145
Other time	23,240	25,836
	\$338,174	\$327,055

The Company held \$29,000,000 in certificates of deposit for the State of California as of December 31, 2013 and 2012. This amount represents 6.0% of total deposit balances at December 31, 2013 and 6.1% at December 31, 2012.

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**9. INTEREST-BEARING DEPOSITS** (Continued)

Aggregate annual maturities of time deposits are as follows (dollars in thousands):

Year Ending December 31,	
2014	\$62,529
2015	6,177
2016	8,190
2017	8,895
2018	6,423
Thereafter	16
	\$92,230

Interest expense recognized on interest-bearing deposits consisted of the following (dollars in thousands):

	Year Ended December 31,		
	2013	2012	2011
Savings	\$68	\$114	\$183
Money market	435	616	1,000
NOW accounts	40	42	44
Time, \$100,000 or more	446	528	601
Other time	208	310	410
	\$1,197	\$1,610	\$2,238

**10. BORROWING ARRANGEMENTS**

The Company has \$17,000,000 in unsecured short-term borrowing arrangements to purchase Federal funds with two of its correspondent banks. There were no advances under the borrowing arrangements as of December 31, 2013 and



2012.

In addition, the Company has a line of credit available with the FHLB which is secured by pledged mortgage loans (see [Note 6](#)) and investment securities (see [Note 5](#)). Borrowings may include overnight advances as well as loans with a term of up to thirty years. Advances totaling \$16,000,000 were outstanding from the FHLB at December 31, 2013, bearing fixed interest rates ranging from 1.19% to 2.73% and maturing between January 13, 2014 and July 12, 2019. Advances totaling \$18,000,000 were outstanding from the FHLB at December 31, 2012, bearing fixed interest rates ranging from 0.67% to 2.73% and maturing between May 20, 2013 and July 12, 2019. Amounts available under the borrowing arrangement with the FHLB at December 31, 2013 and 2012 totaled \$53,021,000 and \$59,254,000, respectively.

In addition, the Company entered into a secured borrowing agreement with the FRB in 2008. The borrowing arrangement is secured by pledging selected loans (see [Note 6](#)) and investment securities (see [Note 5](#)). There were no advances outstanding as of December 31, 2013 and 2012. Amounts available under the borrowing arrangement with the FRB at December 31, 2013 and 2012 totaled \$21,358,000 and \$27,448,000, respectively.

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**10. BORROWING ARRANGEMENTS** (Continued)

The following table summarizes these borrowings (dollars in thousands):

	December 31,					
	2013		2012			
	Amount	Weighted Average Rate	Amount	Weighted Average Rate		
Short-term portion of borrowings	\$8,000	2.15	% \$2,000	0.67	%	
Long-term borrowings	8,000	1.47	% 16,000	1.81	%	
	\$16,000	1.81	% \$18,000	1.68	%	

Maturities on these borrowings are as follows:

Year Ending December 31,	
2014	\$8,000,000
2015	2,000,000
2016	2,000,000
2017	2,000,000
2018	—
Thereafter	2,000,000
	\$16,000,000

The Company has also been issued \$5,800,000 in letters of credit by the FHLB, included in the amounts available from the FHLB previously discussed, which have been pledged to secure Local Agency Deposits. The letters of credit act as a guarantee of payment to certain third parties in accordance with specified terms and conditions. The letters of credit were not drawn upon in 2013 and management does not expect these lines to be drawn in the future.

**11. INCOME TAXES**

The provision for (benefit from) income taxes for the years ended December 31, 2013, 2012, and 2011 consisted of the following (dollars in thousands):

	Federal	State	Total
<u>2013</u>			
Current	\$ 797	\$217	\$1,014
Deferred	162	82	244
Provision for income taxes	\$ 959	\$299	\$1,258

<u>2012</u>			
Current	\$ 379	\$27	\$406
Deferred	368	86	454
Provision for income taxes	\$ 747	\$113	\$860

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 11. INCOME TAXES (Continued)

	Federal	State	Total
<u>2011</u>			
Current	\$1,340	\$367	\$1,707
Deferred	(352 )	(86 )	(438 )
Provision for income taxes	\$988	\$281	\$1,269

Deferred tax assets (liabilities) consisted of the following (dollars in thousands):

	December 31,	
	2013	2012
Deferred tax assets:		
Allowance for loan and lease losses	\$2,442	\$2,637
Other real estate owned	556	1,146
Deferred compensation	2,370	2,006
Other	166	137
Total deferred tax assets	5,534	5,926
Deferred tax liabilities:		
Unrealized gains on available-for-sale investment securities	(749 )	(2,857 )
Future liability of state deferred tax assets	(370 )	(399 )
Deferred loan costs	(233 )	(219 )
Federal Home Loan Bank stock dividends	(211 )	(211 )
Premises and equipment	(112 )	(245 )
Total deferred tax liabilities	(1,675)	(3,931)
Net deferred tax assets	\$3,859	\$1,995

The Company and its subsidiaries file income tax returns in the United States and California jurisdictions. There are currently no pending federal, state or local income tax examinations by tax. Furthermore, with few exceptions, the Company is no longer subject to the examination by federal taxing authorities for the years ended before December 31, 2010 and by state and local taxing authorities for years before December 31, 2009. The unrecognized tax benefits and changes therein and the interest and penalties accrued by the Company as of December 31, 2013 were not significant.

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**11. INCOME TAXES** (Continued)

The provision for income taxes differs from amounts computed by applying the statutory Federal income tax rate of 34% in 2013, 2012 and 2011 to income before income taxes. The significant items comprising these differences consisted of the following:

	Year Ended December 31,		
	2013	2012	2011
Federal income tax statutory rate	34.0%	34.0%	34.0%
State franchise tax, net of Federal tax effect	4.6 %	1.8 %	7.6 %
Tax benefit of interest on obligations of states and political subdivisions	(6.5)%	(7.2)%	(6.6)%
Tax-exempt income from life insurance policies	(2.9)%	(2.2)%	(2.5)%
Equity compensation expense	0.1 %	0.2 %	0.7 %
Other	(0.1)%	(5.5)%	0.4 %
Effective tax rate	29.2%	21.1%	33.6%

**12. COMMITMENTS AND CONTINGENCIES**Leases

The Company leases branch facilities, administrative offices and various equipment under noncancelable operating leases which expire on various dates through the year 2021. Certain of the leases have five year renewal options. One of the branch facilities is leased from a current member of the Company's Board of Directors (see Note 17).

Future minimum lease payments are as follows (dollars in thousands):

Year Ending

December 31,

2014	\$775
2015	713
2016	674
2017	356
2018	160
Thereafter	109
	\$2,787

Rental expense included in occupancy, furniture and equipment expense totaled \$865,000, \$858,000 and \$832,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

#### Financial Instruments With Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business in order to meet the financing needs of its customers and to reduce its exposure to fluctuations in interest rates. These financial instruments consist of commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the consolidated balance sheet.

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**12. COMMITMENTS AND CONTINGENCIES** (Continued)Financial Instruments With Off-Balance-Sheet Risk (Continued)

The Company's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and standby letters of credit as it does for loans included on the consolidated balance sheet.

The following financial instruments represent off-balance-sheet credit risk (dollars in thousands):

	December 31,	
	2013	2012
Commitments to extend credit:		
Revolving lines of credit secured by 1-4 family residences	\$2,071	\$3,644
Commercial real estate, construction and land development commitments secured by real estate	11,890	7,587
Other unused commitments, principally commercial loans	17,720	15,287
	\$31,681	\$26,518
Standby letters of credit	\$6,363	\$6,506

At inception, real estate commitments are generally secured by property with a loan to value ratio of 55% to 75%. In addition, the majority of the Company's commitments have variable interest rates.

Commitments to extend credit are agreements to lend to a client as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total



commitment amounts do not necessarily represent future cash requirements. Each client's creditworthiness is evaluated on a case-by-case basis. The amount of collateral obtained, if deemed necessary upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include accounts receivable, inventory, equipment and deeds of trust on residential real estate and income-producing commercial properties.

Standby letters of credit are conditional commitments issued to guarantee the performance or financial obligation of a client to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to clients.

#### Significant Concentrations of Credit Risk

The Company grants real estate mortgage, real estate construction, commercial, agricultural and consumer loans to clients throughout Sacramento, Placer, Yolo, Amador, El Dorado, and Sonoma counties.

In management's judgment, a concentration exists in real estate-related loans which represented approximately 86% and 83% of the Company's loan portfolio at December 31, 2013 and 2012, respectively. A continued substantial decline in the economy in general, or a continued decline in real estate values in the Company's primary market areas in particular, could have an adverse impact on collectability of these loans. However, personal and business income represents the primary source of repayment for a majority of these loans.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

**12. COMMITMENTS AND CONTINGENCIES (Continued)**

Correspondent Banking Agreements

The Company maintains funds on deposit with other federally insured financial institutions under correspondent banking agreements. The Company had \$2,768,000 in uninsured deposits at December 31, 2013. There were no uninsured deposits at December 31, 2012.

Contingencies

The Company is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the consolidated financial position or results of operations of the Company.

**13. SHAREHOLDERS' EQUITY**

Earnings Per Share

A reconciliation of the numerators and denominators of the basic and diluted earnings per share computations is as follows (dollars and shares in thousands, except per share data):

	Net	Weighted Average Number of Shares Outstanding	Per-Share Amount
For the Year Ended	Income		

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December 31, 2013

Basic earnings per share	\$ 3,057	8,888	\$ 0.34
Effect of dilutive stock-based compensation	—	6	
Diluted earnings per share	\$ 3,057	8,894	\$ 0.34

December 31, 2012

Basic earnings per share	\$ 3,207	9,483	\$ 0.34
Effect of dilutive stock-based compensation	—	9	
Diluted earnings per share	\$ 3,207	9,492	\$ 0.34

December 31, 2011

Basic earnings per share	\$ 2,504	9,852	\$ 0.25
Effect of dilutive stock-based compensation	—	6	
Diluted earnings per share	\$ 2,504	9,858	\$ 0.25

Stock options for 277,923 shares, 305,670 shares and 358,198 shares of common stock were not considered in computing diluted earnings per common share for the years ended December 31, 2013, 2012 and 2011, respectively, because they were antidilutive.

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**13.SHAREHOLDERS' EQUITY** (Continued)Stock Based Compensation

In 2000, the Board of Directors adopted and the Company's shareholders approved a stock option plan (the "2000 Plan"), under which 260,594 options remain outstanding at December 31, 2013. On March 17, 2010, the Board of Directors adopted the 2010 Equity Incentive Plan (the "2010 Plan"). The 2010 Plan was approved by the Company's shareholders on May 20, 2010. The total number of authorized shares that are available for issuance under the 2010 Plan is 1,432,312. The 2010 Plan provides for the following types of stock-based awards: incentive stock options; nonqualified stock options; stock appreciation rights; restricted stock; restricted performance stock; unrestricted Company stock; and performance units. Awards granted under the 2000 Plan were either incentive stock options or nonqualified stock options. The 2010 Plan and the 2000 Plan (collectively the "Plans"), under which equity incentives may be granted to employees and directors under incentive and nonstatutory agreements, require that the option price may not be less than the fair value of the stock at the date the option is granted. The option awards under the Plans expire on dates determined by the Board of Directors, but not later than ten years from the date of award. The vesting period is generally five years; however, the vesting period can be modified at the discretion of the Company's Board of Directors. Outstanding option awards under the Plans are exercisable until their expiration; however, no new options will be awarded under the 2000 Plan. The Plans do not provide for the settlement of awards in cash and new shares are issued upon exercise of an option.

A summary of the outstanding and nonvested stock option activity for the year ended December 31, 2013 is as follows:

	Outstanding		Nonvested	
	Shares	Weighted Average Exercise Price Per Share	Shares	Weighted Average Grant Date Fair Value Per Share
Balance, January 1, 2013	305,670	\$ 16.71	43,537	\$ 1.73

Options granted				
Options vested			(20,986)	\$ 2.28
Options expired or canceled	(27,747)	\$ 11.71		
Balance, December 31, 2013	277,923	\$ 18.06	22,551	\$ 1.70

A summary of options as of December 31, 2013 is as follows:

Nonvested:

Weighted average exercise price of nonvested stock options	\$7.63
Aggregate intrinsic value of nonvested stock options	\$41,237
Weighted average remaining contractual term in years of nonvested stock options	7.13

Vested:

Number of vested stock options	255,372
Number of options expected to vest	16,913
Weighted average exercise price per share	\$18.06
Aggregate intrinsic value	\$41,186
Weighted average remaining contractual term in years	2.75

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 13. SHAREHOLDERS' EQUITY (Continued)

Stock Based Compensation (Continued)

Range of Exercise Prices	Number of Options Outstanding December 31, 2013	Weighted Average Remaining Contractual Life	Number of Options Exercisable December 31, 2013
\$7.07- \$11.66	60,676	6.06 years	38,139
\$11.67- \$16.77	44,296	4.15 years	44,289
\$16.78 - \$18.10	38,928	.30 years	38,928
\$18.11 - \$18.23	31,998	1.29 years	31,993
\$18.24 - \$24.07	102,025	2.53 years	102,023
	277,923		255,372

Restricted Stock

There were 11,448 shares of restricted stock awarded during the second quarter of 2013. The restricted common shares awarded in 2013 vest one year from the date of the award. The weighted average contractual term over which the restricted stock will vest is a single year. There were 16,207 shares of restricted stock awarded during the second quarter of 2012. Of the 16,207 restricted common shares, 9,898 will vest one year from the date of the award and 6,309 will vest 20% per year from the date of the award. The weighted average contractual term over which the restricted stock will vest is 1.42 years.

Weighted  
Average  
Grant  
Date

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Restricted Stock	Shares	Fair Value
Nonvested at January 1, 2013	26,969	\$ 6.79
Awarded	11,448	7.86
Vested	14,427	6.94
Cancelled		
Nonvested at December 31, 2013	23,990	7.22

The shares awarded to employees and directors under the restricted stock agreements vest on applicable vesting dates only to the extent the recipient of the shares is then an employee or a director of the Company or one of its subsidiaries, and each recipient will forfeit all of the shares that have not vested on the date his or her employment or service is terminated. New shares are issued upon vesting of the restricted common stock.

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AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

**13. SHAREHOLDERS' EQUITY (Continued)**

Common Stock Repurchase Program

During 2012, the Company approved and authorized a stock repurchase program for 2012 (the "2012 Program"). The 2012 Program authorized the repurchase during 2012 of up to 6% of the outstanding shares of the Company's common stock. During 2012, the Company repurchased 575,389 shares of its common stock at an average price of \$7.29 per share. On December 20, 2012, the Company approved and authorized a stock repurchase program for 2013 (the "2013 Program"). The 2013 Program authorized the repurchase during 2013 of up to 10% of the outstanding shares of the Company's common stock. During 2013, the Company repurchased 849,404 shares of its common stock at an average price of \$8.24 per share. On January 17, 2014, the Company approved and authorized a stock repurchase program for 2014 (the "2014 Program"). The 2014 Program authorized the repurchase during 2014 of up to 5% of the outstanding shares of the Company's common stock, or approximately 424,462 shares based on the 8,489,247 shares outstanding as of December 31, 2013. Any repurchases under the 2014 Program will be made from time to time by the Company in the open market as conditions allow. All such transactions will be structured to comply with Commission Rule 10b-18 and all shares repurchased under the 2014 Program will be retired. The number, price and timing of the repurchases will be at the Company's sole discretion and the 2014 Program may be re-evaluated depending on market conditions, capital and liquidity needs or other factors. Based on such re-evaluation, the Board of Directors may suspend, terminate, modify or cancel the 2014 Program at any time without notice.

**14. REGULATORY MATTERS**

Dividends

Upon declaration by the Board of Directors of the Company, all shareholders of record will be entitled to receive dividends. There is no assurance, however, that any dividends will be paid in the future since they are subject to regulatory restrictions, and dependent upon earnings, financial condition and capital requirements of the Company and its subsidiaries. On July 24, 2009, the Board of Directors temporarily suspended the payment of cash dividends until such time as it is prudent to reestablish payment of cash dividends. As a result there were no cash dividends declared or paid in 2011, 2012 or 2013.



As a California corporation, the Company's ability to pay cash dividends is subject to restrictions set forth in the California General Corporation Law (the "Corporation Law"). The Corporation Law provides that neither a corporation nor any of its subsidiaries shall make a distribution to the corporation's shareholders unless the board of directors has determined in good faith either of the following: (1) the amount of retained earnings of the corporation immediately prior to the distribution equals or exceeds the sum of (A) the amount of the proposed distribution plus (B) the preferential dividends arrears amount; or (2) immediately after the distribution, the value of the corporation's assets would equal or exceed the sum of its total liabilities plus the preferential rights amount. The good faith determination of the board of directors may be based upon (1) financial statements prepared on the basis of reasonable accounting practices and principles, (2) a fair valuation, or (3) any other method reasonable under the circumstances; provided, that a distribution may not be made if the corporation or subsidiary making the distribution is, or is likely to be, unable to meet its liabilities (except those whose payment is otherwise adequately provided for) as they mature. The term "preferential dividends arrears amount" means the amount, if any, of cumulative dividends in arrears on all shares having a preference with respect to payment of dividends over the class or series to which the applicable distribution is being made, provided that if the articles of incorporation provide that a distribution can be made without regard to preferential dividends arrears amount, then the preferential dividends arrears amount shall be zero. The term "preferential rights amount" means the amount that would be needed if the corporation were to be dissolved at the time of the distribution to satisfy the preferential rights, including accrued but unpaid dividends, of other shareholders upon dissolution that are superior to the rights of the shareholders receiving the distribution, provided that if the articles of incorporation provide that a distribution can be made without regard to any preferential rights, then the preferential rights amount shall be zero.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Continued)

**14. REGULATORY MATTERS (Continued)**

In addition, the California Financial Code restricts the total dividend payment of any state banking corporation in any calendar year to the lesser of (1) the bank's retained earnings or (2) the bank's net income for its last three fiscal years, less distributions made to shareholders during the same three-year period. In addition, subject to prior regulatory approval, any state banking corporation may request an exception to this restriction.

Regulatory Capital

The Company and ARB are subject to certain regulatory capital requirements administered by the Board of Governors of the Federal Reserve System and the FDIC. Failure to meet these 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 Company's consolidated financial statements.

Under capital adequacy guidelines, the Company and ARB must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. These quantitative measures are established by regulation and require that minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets be maintained. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**14. REGULATORY MATTERS** (Continued)Regulatory Capital (Continued)

To be categorized as well capitalized, ARB must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below.

Management believes that the Company and ARB met all their capital adequacy requirements as of December 31, 2013 and 2012.

	December 31,			
	2013		2012	
	Amount	Ratio	Amount	Ratio
	(dollars in thousands)			
<b>Leverage Ratio</b>				
American River Bankshares and Subsidiaries	\$69,576	11.9 %	\$73,388	12.8 %
Minimum regulatory requirement	\$23,433	4.0 %	\$22,900	4.0 %
American River Bank	\$69,705	11.9 %	\$72,284	12.6 %
Minimum requirement for "Well-Capitalized" institution	\$29,276	5.0 %	\$28,600	5.0 %
Minimum regulatory requirement	\$23,421	4.0 %	\$22,880	4.0 %
<b>Tier 1 Risk-Based Capital Ratio</b>				
American River Bankshares and Subsidiaries	\$69,576	22.0 %	\$73,388	23.9 %
Minimum regulatory requirement	\$12,681	4.0 %	\$12,297	4.0 %
American River Bank	\$69,705	22.0 %	\$72,284	23.5 %
Minimum requirement for "Well-Capitalized" institution	\$19,003	6.0 %	\$18,425	6.0 %
Minimum regulatory requirement	\$12,669	4.0 %	\$12,283	4.0 %

Total Risk-Based Capital Ratio

American River Bankshares and Subsidiaries	\$73,556	23.2 %	\$77,255	25.1 %
Minimum regulatory requirement	\$25,471	8.0 %	\$24,747	8.0 %
American River Bank	\$73,681	23.3 %	\$76,146	24.8 %
Minimum requirement for "Well-Capitalized" institution	\$31,809	10.0 %	\$30,900	10.0 %
Minimum regulatory requirement	\$25,447	8.0 %	\$24,720	8.0 %

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**15. OTHER NONINTEREST INCOME AND EXPENSE**

Other noninterest income consisted of the following (dollars in thousands):

	Year Ended December 31,		
	2013	2012	2011
Merchant fee income	\$443	\$531	\$467
Rental income from OREO properties	316	886	37
Increase in cash surrender value of life insurance policies (Note 16)	247	267	272
Other	383	273	218
	\$1,389	\$1,957	\$994

Other noninterest expense consisted of the following (dollars in thousands):

	Year Ended December 31,		
	2013	2012	2011
Professional fees	\$933	\$1,031	\$1,037
Outsourced item processing	357	379	427
Directors' expense	348	384	327
Telephone and postage	329	335	330
Amortization of intangible assets	—	183	219
Stationery and supplies	240	229	183
Advertising and promotion	284	268	231
Other operating expenses	596	959	1,004
	\$3,087	\$3,768	\$3,758

## **16.EMPLOYEE BENEFIT PLANS**

### American River Bankshares 401(k) Plan

The American River Bankshares 401(k) Plan has been in place since January 1, 1993 and is available to all employees. Under the plan, the Company will match 100% of each participant's contribution up to 3% of annual compensation plus 50% of the next 2% of annual compensation. Employer Safe Harbor matching contributions are 100% vested upon entering the plan. The Company's contributions totaled \$181,000, \$184,000 and \$172,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

### Employee Stock Purchase Plan

The Company contracts with an administrator for an Employee Stock Purchase Plan which allows employees to purchase the Company's stock at fair market value as of the date of purchase. The Company bears all costs of administering the Plan, including broker's fees, commissions, postage and other costs actually incurred.

AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

**16.EMPLOYEE BENEFIT PLANS** (Continued)

American River Bankshares Deferred Compensation Plan

The Company has established a Deferred Compensation Plan for certain members of the management team and a Deferred Fee Agreement for Non-Employee Directors for the purpose of providing the opportunity for participants to defer compensation. Participants of the management team, who are selected by a committee designated by the Board of Directors, may elect to defer annually a minimum of \$5,000 or a maximum of eighty percent of their base salary and all of their cash bonus. Directors may also elect to defer up to one hundred percent of their monthly fees. The Company bears all administration costs and accrues interest on the participants' deferred balances at a rate based on U.S. Government Treasury rates plus 4.0%. This rate was 4.72% at December 31, 2013. Deferred compensation, including interest earned, totaled \$2,543,000 and \$2,436,000 at December 31, 2013 and 2012, respectively. The expense recognized under this plan totaled \$117,000, \$116,000 and \$138,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

Salary Continuation Plan

The Company has agreements to provide certain current executives, or their designated beneficiaries, with annual benefits for up to 15 years after retirement or death. These benefits are substantially equivalent to those available under life insurance policies purchased by the Company on the lives of the executives. The Company accrues for these future benefits from the effective date of the agreements until the executives' expected final payment dates in a systematic and rational manner. As of December 31, 2013 and 2012, the Company had accrued \$1,132,000 and \$1,054,000, respectively, for potential benefits payable. This payable approximates the then present value of the benefits expected to be provided at retirement and is included in accrued interest payable and other liabilities on the consolidated balance sheet. The expense recognized under this plan totaled \$170,000, \$143,000 and \$166,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

In connection with these plans, the Company invested in single premium life insurance policies with cash surrender values totaling \$12,686,000 and \$12,858,000 at December 31, 2013 and 2012, respectively. On the consolidated balance sheet, the cash surrender value of life insurance policies is included in accrued interest receivable and other assets. Tax-exempt income on these policies, net of expense, totaled approximately \$365,000, \$267,000 and \$272,000

for the years ended December 31, 2013, 2012 and 2011, respectively. In 2013, \$118,000 of this tax-exempt income was from the death benefit proceeds of a life insurance policy on a former director.

## 17. RELATED PARTY TRANSACTIONS

During the normal course of business, the Company enters into transactions with related parties, including Directors and affiliates. The following is a summary of the aggregate activity involving related party borrowers during 2013 (dollars in thousands):

Balance, January 1, 2013	\$3,795
Disbursements	275
Amounts repaid	(129 )
Balance, December 31, 2013	\$3,941

There are no undisbursed commitments to related parties as of December 31, 2013.

The Company also leases one of its branch facilities from a current member of the Company's Board of Directors. Rental payments to the Director totaled \$105,000, \$105,000 and \$100,000 for the years ended December 31, 2013, 2012 and 2011, respectively.



## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 18. PARENT ONLY CONDENSED FINANCIAL STATEMENTS

## CONDENSED BALANCE SHEETS

December 31, 2013 and 2012

(Dollars in thousands)

	2013	2012
ASSETS		
Cash and due from banks	\$416	\$661
Investment in subsidiaries	87,149	92,890
Other assets	291	1,339
	\$87,856	\$94,890
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Other liabilities	\$836	\$896
Total liabilities	836	896
Shareholders' equity:		
Common stock	61,108	67,977
Retained earnings	24,789	21,732
Accumulated other comprehensive income, net of taxes	1,123	4,285
Total shareholders' equity	87,020	93,994
	\$87,856	\$94,890

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## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 18. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (Continued)

## CONDENSED STATEMENTS OF INCOME

For the Years Ended December 31, 2013, 2012 and 2011

(Dollars in thousands)

	2013	2012	2011
Income:			
Dividends declared by subsidiaries – eliminated in consolidation	\$6,000	\$1,000	\$—
Management fee from subsidiaries – eliminated in consolidation	—	—	2,840
Other income	—	—	28
Total income	6,000	1,000	2,868
Expenses:			
Salaries and employee benefits	—	1	2,396
Professional fees	91	98	253
Directors' expense	247	285	260
Other expenses	205	216	538
Total expenses	543	600	3,447
Income (loss) before equity in undistributed income of subsidiaries	5,457	400	(579 )
Equity in (distributed) undistributed income of subsidiaries	(2,623)	2,560	2,845
Income before income taxes	2,834	2,960	2,266
Income tax benefit	223	247	238
Net income	\$3,057	\$3,207	\$2,504

## AMERICAN RIVER BANKSHARES AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

## 18. PARENT ONLY CONDENSED FINANCIAL STATEMENTS (Continued)

## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2013, 2012 and 2011

(Dollars in thousands)

	2013	2012	2011
Cash flows from operating activities:			
Net income	\$3,057	\$3,207	\$2,504
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Distributed (undistributed) earnings of subsidiaries	2,623	(2,560)	(2,845)
Equity-based compensation expense	131	155	202
Decrease (increase) in other assets	1,004	(1,209)	2,067
(Decrease) increase in other liabilities	(60 )	110	(3,091)
Net cash provided (used in) by operating activities	6,755	(297 )	(1,163)
Cash flows from investing activities:			
Purchase of equipment	—	—	(36 )
Sale of equipment	—	—	194
Net cash provided by investing activities	—	—	158
Cash flows from financing activities:			
Cash paid to repurchase common stock	(7,000)	(4,194)	—
Net cash used in financing activities	(7,000)	(4,194)	—
Net decrease in cash and cash equivalents	(245 )	(4,491)	(1,005)
Cash and cash equivalents at beginning of year	661	5,152	6,157

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Cash and cash equivalents at end of year	\$416	\$661	\$5,152
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**Selected Quarterly Information (Unaudited)**

(In thousands, except per share and price range of common stock)

	March 31,	June 30,	September 30,	December 31,
2013				
Interest income	\$4,651	\$4,551	\$ 4,757	\$ 4,922
Net interest income	4,244	4,176	4,396	4,575
Provision for loan and lease losses	100	100	—	—
Noninterest income	625	448	462	480
Noninterest expense	4,002	3,612	3,536	3,741
Income before taxes	767	912	1,322	1,314
Net income	622	652	893	890
Basic earnings per share	\$.07	\$.07	\$ .10	\$ .10
Diluted earnings per share	.07	.07	.10	.10
Cash dividends per share	—	—	—	—
Price range, common stock	\$6.75-7.95	\$7.39-9.53	\$ 8.62-8.91	\$ 7.89-9.58
2012				
Interest income	\$5,510	\$5,324	\$ 5,334	\$ 5,131
Net interest income	5,008	4,842	4,864	4,691
Provision for loan and lease losses	580	375	410	—
Noninterest income	693	694	712	675
Noninterest expense	4,112	4,051	4,219	4,365
Income before taxes	1,009	1,110	947	1,001
Net income	712	845	780	870
Basic earnings per share	\$.07	\$.09	\$ .08	\$ .09
Diluted earnings per share	.07	.09	.08	.09
Cash dividends per share	—	—	—	—
Price range, common stock	\$4.50-7.90	\$6.25-8.31	\$ 6.41-7.71	\$ 6.21-7.89

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

There have been no disagreements with such independent registered public accountants during the last two fiscal years ended December 31, 2013, on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

Item 9A. Controls and Procedures.

### **Effectiveness of Disclosure Controls and Procedures**

The Company, under the supervision and with the participation of its management, including the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures" (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of December 31, 2013. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely making known to them material information relating to the Company and the Company's consolidated subsidiaries required to be disclosed in the Company's reports filed or submitted under the Exchange Act.

During the quarter ended December 31, 2013, there have been no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, these controls.

### **Report of Management on Internal Control Over Financial Reporting**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting for the Company (as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended).

The Company's management, including the Chief Executive Officer and Chief Financial Officer, has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2013, presented in conformity with accounting principles generally accepted in the United States of America. In making this assessment, management used the criteria applicable to the Company as set forth by the Committee of Sponsoring Organizations of the Treadway Commission in the 1992 *Internal Control—Integrated Framework*. Based upon such assessment, management believes that, as of December 31, 2013, the Company's internal control over financial reporting is effective based upon those criteria.

This Annual Report on Form 10-K does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's independent registered public accounting firm pursuant to the rules of the Securities and Exchange Commission that permit the Company to provide only management's report in this Annual Report on Form 10-K.

/s/ DAVID T. TABER

/s/ MITCHELL A. DERENZO

David T. Taber	Mitchell A. Derenzo
President and Chief Executive Officer	Executive Vice President and Chief Financial Officer

**Item 9B. Other Information.**

None.

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### **PART III**

#### **Item 10. Directors, Executive Officers and Corporate Governance.**

The information required by Item 10 of Form 10-K is incorporated by reference to the information contained in the Company's Proxy Statement for the 2014 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14A.

#### **Item 11. Executive Compensation.**

The information required by Item 11 of Form 10-K is incorporated by reference to the information contained in the Company's Proxy Statement for the 2014 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14A.

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

The information required by Item 12 of Form 10-K is incorporated by reference to the information contained in the Company's Proxy Statement for the 2014 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14A.

#### **Item 13. Certain Relationships and Related Transactions, and Director Independence.**

The information required by Item 13 of Form 10-K is incorporated by reference to the information contained in the Company's Proxy Statement for the 2014 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14A.

#### **Item 14. Principal Accounting Fees and Services.**

The information required by Item 14 of Form 10-K is incorporated by reference to the information contained in the Company's Proxy Statement for the 2014 Annual Meeting of Shareholders which will be filed pursuant to Regulation 14A.

### **PART IV**



**Item 15. Exhibits and Financial Statement Schedules.**

Financial  
Statements.  
(a)(1) Listed and  
included in  
Part II, Item  
8.

Financial  
Statement  
(2) Schedules.  
Not  
applicable.

(3) Exhibits.

Exhibit  
Number Document Description

(2.1) Agreement and Plan of Reorganization and Merger by and among the Registrant, ARH Interim National Bank and North Coast Bank, N.A., dated as of March 1, 2000 (included as Annex A). \*\*

(2.2) Agreement and Plan of Reorganization and Merger by and among the Registrant, American River Bank and Bank of Amador, dated as of July 8, 2004 (included as Annex A). \*\*\*

(3.1) Articles of Incorporation, as amended, incorporated by reference from Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2011, filed with the Commission on May 10, 2011.

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- (3.2) Bylaws, as amended, incorporated by reference from Exhibit 3.2 to the Registrant's Quarterly Report on Form 10-Q for the period ended March 31, 2013, filed with the Commission on May 9, 2013.

Specimen of the Registrant's common stock certificate, incorporated by reference from Exhibit 4.1 to the

- (4.1) Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed with the Commission on August 11, 2004.

Lease agreement between American River Bank and Spieker Properties, L.P., a California limited partnership, dated April 1, 2000, related to 1545 River Park Drive, Suite 107, Sacramento, California (\*\*)

- (10.1) Amendment thereto dated August 27, 2010, with HINES VAF II SACRAMENTO PROPERTIES, L.P., a Delaware limited partnership, the successor to Spieker Properties, L.P., incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on August 30, 2010.

- (10.2) Lease agreement between American River Bank and Bradshaw Plaza Associates, Inc. dated November 27, 2006, related to 9750 Business Park Drive, Sacramento, California, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on November 28, 2006.

Lease agreement between American River Bank and Marjorie Wood Taylor, Trustee of the Marjorie

Wood-Taylor Trust, dated April 5, 1984, and addendum thereto dated July 16, 1997, related to 10123 Fair

- (10.3) Oaks Boulevard, Fair Oaks, California (\*\*)
- and Amendment No. 2 thereto dated May 14, 2009, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on May 15, 2009.

Lease agreement between American River Bank and LUM YIP KEE, Limited (formerly Sandalwood Land Company) dated August 28, 1996, related to 2240 Douglas Boulevard, Suite 100, Roseville, California (\*\*)

- (10.4) and Amendment No. 1 thereto dated July 28, 2006, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on July 31, 2006.

- \*(10.5) Registrant's Deferred Compensation Plan, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 3, 2012.

- \*(10.6) Registrant's Deferred Fee Plan, incorporated by reference from Exhibit 99.2 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 3, 2012.

Lease agreement between American River Bank and 520 Capitol Mall, Inc., dated August 19, 2003, related to 520 Capitol Mall, Suite 100, Sacramento, California, incorporated by reference from Exhibit 10.29 to the

- (10.7) Registrant's Quarterly Report on Form 10-Q for the period ended September 30, 2003, filed with the Commission on November 7, 2003 and the First Amendment thereto dated April 21, 2004, incorporated by reference from Exhibit 10.37 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed with the Commission on August 11, 2004.

- \*(10.8) Employment Agreement between Registrant and David T. Taber dated June 2, 2006, incorporated by reference from Exhibit 99.3 to the Registrant's Current Report on Form 8-K, filed with the Commission on May 30, 2006.

Salary Continuation Agreement, as amended on December 31, 2012, between American River Bank and

- \*(10.9) Mitchell A. Derenzo, incorporated by reference from Exhibit 99.3 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 2, 2013.

Salary Continuation Agreement, as amended on December 31, 2012, between the Registrant and David T.

- \*(10.10) Taber, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 2, 2013.



- Salary Continuation Agreement, as amended on February 21, 2008, between American River Bank and
- \*(10.11) Douglas E. Tow, incorporated by reference from Exhibit 99.2 to the Registrant's Current Report on Form 8-K, filed with the Commission on February 22, 2008.
- \*(10.12) Registrant's 2000 Stock Option Plan with forms of Nonqualified Stock Option Agreement and Incentive Stock Option Agreement. \*\*
- \*(10.13) Registrant's 401(k) Plan dated December 23, 2008, incorporated by reference from Exhibit 99.1 to the Current Report on Form 8-K, filed with the Commission on December 24, 2008.
- Lease agreement between Bank of Amador, a division of American River Bank, and the United States Postal
- (10.14) Service, dated May 24, 2011, related to 424 Sutter Street, Jackson, California, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on May 25, 2011.
- Salary Continuation Agreement, as amended on February 21, 2008, between Bank of Amador, a division of
- \*(10.15) American River Bank, and Larry D. Standing and related Endorsement Split Dollar Agreement, incorporated by reference from Exhibit 99.4 to the Registrant's Report on Form 8-K, filed with the Commission on February 22, 2008.
- Director Retirement Agreement, as amended on February 21, 2008, between Bank of Amador, a division of
- \*(10.16) American River Bank, and Larry D. Standing, incorporated by reference from Exhibit 99.5 to the Registrant's Current Report on Form 8-K, filed with the Commission on February 22, 2008.
- Item Processing Agreement between American River Bank and Fidelity Information Services, Inc., dated
- (10.17) April 30, 2012, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on May 4, 2012.
- Lease agreement between Registrant and One Capital Center, a California limited partnership, dated May 17,
- (10.18) 2005, related to 3100 Zinfandel Drive, Rancho Cordova, California, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on May 18, 2005 and the First Amendment thereto dated April 23, 2010, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on April 23, 2010.
- Managed Services Agreement between American River Bankshares and ProNet Solutions, Inc., dated June
- (10.19) 25, 2012, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on June 27, 2012.
- \*(10.20) American River Bankshares 2005 Executive Incentive Plan, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on October 27, 2005; the First Amendment thereto, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on March 17, 2006; the Second Amendment thereto, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on March 23, 2007; the Third Amendment thereto, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on February 22, 2008; the Fourth Amendment thereto, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on March 20, 2009; the Fifth Amendment thereto, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on March 18, 2010; the Sixth Amendment thereto, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on March 17, 2011; the Seventh Amendment thereto,

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incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on February 17, 2012; the Eight Amendment thereto, incorporated by reference from the Registrant's Current Report on Form 8-K, filed with the Commission on January 31, 2013, and the Ninth Amendment thereto, incorporated by reference from the Registrant's Current Report on Form 8-K, filed with the Commission on January 16, 2014.

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- American River Bankshares Director Emeritus Program, incorporated by reference from Exhibit 10.33 to
- \*(10.21) the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2006, filed with the Commission on August 8, 2006.  
Employment Agreement dated September 20, 2006, between American River Bankshares and Mitchell A.
- \*(10.22) Derenzo, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on September 20, 2006.  
Employment Agreement dated September 20, 2006, between American River Bankshares and Kevin B.
- \*(10.23) Bender, incorporated by reference from Exhibit 99.3 to the Registrant's Current Report on Form 8-K, filed with the Commission on September 20, 2006.  
Salary Continuation Agreement, as amended on December 31, 2012, between American River Bank and
- \*(10.24) Kevin B. Bender, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 2, 2013.  
Salary Continuation Agreement, as amended on February 21, 2008, between American River Bank and
- \*(10.25) Raymond F. Byrne, incorporated by reference from Exhibit 99.7 to the Registrant's Current Report on Form 8-K, filed with the Commission on February 22, 2008.
- Lease agreement dated May 23, 2007 between Bank of Amador, a division of American River Bank, and Joseph Bellamy, Trustee of the Joseph T. Bellamy 2005 Trust, related to 26395 Buckhorn Ridge Road, Pioneer, California, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form
- (10.26) 8-K, filed with the Commission on May 24, 2007 and the First Amendment thereto, dated October 15, 2007, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on October 16, 2007.  
Lease agreement dated December 23, 2008, between North Coast Bank, a division of American River Bank,
- (10.27) and 90 E Street LLC, related to 90 E Street, Santa Rosa, California, incorporated by reference from Exhibit 99.3 to the Registrant's Current Report on Form 8-K, filed with the Commission on December 24, 2008.  
Customer Service Agreement dated January 4, 2010, between American River Bankshares and TriNet HR
- (10.28) Corporation, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 5, 2010.
- Form of Indemnification Agreement entered into on January 20, 2010, between American River Bankshares
- \*(10.29) and its Directors and certain named executive officers, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 22, 2010.  
Form of Indemnification Agreement entered into on January 20, 2010, between American River Bank and its
- \*(10.30) Directors and certain named executive officers, incorporated by reference from Exhibit 99.2 to the Registrant's Current Report on Form 8-K, filed with the Commission on January 22, 2010.  
Registrant's 2010 Equity Incentive Plan, incorporated by reference from the Registrant's Definitive Proxy
- \*(10.31) Statement for its 2010 Annual Meeting of Shareholders, filed with the Commission on April 9, 2010.  
Employment Agreement dated February 1, 2012, between American River Bank and Robert H. Muttera,
- \*(10.32) incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on February 8, 2012.

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(10.33) Subscription and Services Agreement between American River Bank and Postilion, Inc., dated June 19, 2012, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on June 21, 2012.

\*(10.34) Salary Continuation Agreement between American River Bank and Robert H. Muttera, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on February 4, 2013.

(10.35) Lease agreement dated February 6, 2014, between American River Bank and Gold River Village Associates, a California Limited Partnership, related to 11220 Gold River Express Drive, Gold River, California, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on February 10, 2014.

(10.36) Lease agreement dated February 12, 2014, between American River Bank and 520 Capitol Mall Inc., a Delaware corporation, related to 520 Capitol Mall, Suite 200, Sacramento, California, incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K, filed with the Commission on February 18, 2014.

(14.1) Registrant's Code of Ethics, incorporated by reference from Exhibit 14.1 to the Registrant's Annual Report on Form 10-K for the period ended December 31, 2003, filed with the Commission on March 19, 2004.

(21.1) The Registrant's only subsidiaries are American River Bank, a California banking corporation, and American River Financial, a California corporation.

(23.1) Consent of Crowe Horwath LLP.

(31.1) Certifications of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

(31.2) Certifications of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

(32.1) Certification of American River Bankshares by its Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INSXBRL Instance Document\*\*\*\*

101.SCHXBRL Taxonomy Extension Schema\*\*\*\*

101.CALXBRL Taxonomy Extension Calculation\*\*\*\*

101.DEF XBRL Taxonomy Extension Definition\*\*\*\*

101.LABXBRL Taxonomy Extension Label\*\*\*\*

101.PREXBRL Taxonomy Extension Presentation\*\*\*\*

\*Denotes management contracts, compensatory plans or arrangements.

\*\*Incorporated by reference to Registrant's Registration Statement on Form S-4 (No. 333-36326) filed with the Commission on May 5, 2000.

\*\*\*Incorporated by reference to Registrant's Registration Statement on Form S-4 (No. 333-119085) filed with the Commission on September 17, 2004.

\*\*\*\*These interactive data files shall not be deemed filed for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability

under those sections.

An Annual Report for the fiscal year ended December 31, 2013 and Notice of Annual Meeting and Proxy Statement for the Company's 2014 Annual Meeting will be mailed to security holders subsequent to the date of filing this Report. Copies of said materials will be furnished to the Commission in accordance with the Commission's Rules and Regulations.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

## AMERICAN RIVER BANKSHARES

February 27, 2014 By: /s/ DAVID T. TABER  
David T. Taber  
Chief Executive Officer  
(Principal Executive Officer)

February 27, 2014 By: /s/ MITCHELL A. DERENZO  
Mitchell A. Derenzo  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant in the capacities and on the dates indicated.

Signature	Title	Date
/s/ CHARLES D. FITE Charles D. Fite	Director, Chairman	2/27/14
/s/ ROGER J. TAYLOR Roger J. Taylor	Director, Vice Chairman	2/27/14
/s/ MITCHELL A. DERENZO Mitchell A. Derenzo	Chief Financial Officer (Principal Financial and Accounting Officer)	2/27/14
/s/ KIMBERLY A. BOX Kimberly A. Box	Director	2/27/14
/s/ ROBERT J. FOX Robert J. Fox	Director	2/27/14
/s/ WILLIAM A. ROBOTHAM William A. Robotham	Director	2/27/14
/s/ DAVID T. TABER David T. Taber	Director, Chief Executive Officer (Principal Executive Officer)	2/27/14
/s/ STEPHEN H. WAKS Stephen H. Waks	Director	2/27/14
/s/ PHILIP A. WRIGHT Philip A. Wright	Director	2/27/14
/s/ MICHAEL A. ZIEGLER Michael A. Ziegler	Director	2/27/14



**EXHIBIT INDEX**

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31.2	Certifications of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	127
32.1 124	Certification of American River Bankshares Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	128