Dear Fellow Shareholder:

On behalf of the Board of Directors and employees of your Company, we are pleased to provide you with our 2022 annual report. A continued adherence to our strategic objectives once again produced excellent financial results for the year, including continued sustained growth in our deposit and loan portfolios. As a result, we were able to reward our shareholders with a cash distribution of $1.60 per share in 2022.

As North Central West Virginia's premier community bank, we strive to provide our customers reliable services and affordable products. We understand that 2022 was a struggle for most individuals and businesses as both inflation and increased interest rates were the topic of economic discussions, however, we are pleased to report that we continued to emphasize customer satisfaction during this time of economic uncertainty with our high service standards, state-of-the-art electronic banking products and services, and a dedicated staff to execute beyond expectations.

Moving forward into 2023, there is much ambiguity on whether interest rates will rise or fall in the future. Inflationary concerns, economic policy, and the recent failing of regional banks in California and New York could influence the monetary policy crafted by the Federal Reserve. However, your Company wants you to know that it is in a strong liquidity and capital position, our interest rate risk is being monitored diligently, and the safety of our customers' funds is our greatest priority.

We made improvements in our overall branch structure, with the relocation of our Suncrest (Morgantown) branch from 3081 University Ave. to 3051 University Ave in May 2022 and the opening of our new Pierpont (Morgantown) branch in September 2022. Both branches are fully operational, and continue to offer all the same great services, products, and customer service in newly renovated and state-of-the-art of the buildings.

We are happy to report stronger than expected earnings in 2022, as we continue to look for ways to enhance shareholder value through growth and process improvements. You can be an immense part of enhancing our shareholder value by referring First Exchange Bank to your family, friends, and business associates. We are certain they will be pleased with our competitive personal products, business solutions, and our qualified, friendly staff.

We strive for total customer satisfaction while giving back to the community. The company and its employees have contributed to multiple causes during 2022, including Tygart Valley United Way, Mannington District Fair, Bonnie's Bus in support of breast cancer awareness, the Marion County Humane Society, the Mannington Hough Park Pool, Mountaineer Area Council, and other various causes. We are grateful to be a community bank that is focused on building better communities.

As regulatory and interest rate environments evolve, we are well-positioned to adapt to new opportunities and challenges. Our strong capital base, experienced leadership team, and dedication to unparalleled customer care will continue to fuel positive momentum in 2023 and beyond. Lastly, we thank our loyal customers, our talented staff, and our Board of Directors for continuing to rise to the challenge.

Sincerely,

W F Goettel

William F. Goettel, CPA
President

Five Year Performance Summary

(unaudited)

$ (thousands, except ratios)	2022	2021	2020	2019	2018
Income and expense:					
Interest income	$ 13,274	$ 12,967	$ 14,327	$ 13,823	$ 11,349
Interest expense	1,376	2,102	2,885	2,970	1,804
Provision for loan losses	613	1,549	1,120	813	1,291
Noninterest income	1,716	1,652	1,462	1,570	1,938
Noninterest expense	9,706	7,914	8,403	7,968	7,265
Net income	3,296	3,055	3,381	3,642	2,927
Per common share data:					
Net income	$ 2.73	$ 2.53	$ 2.79	$ 3.41	$ 2.76
Book value after AOCI (1)	16.76	20.50	20.11	19.02	15.95
Total Distributions	1.60	1.70	2.02	1.63	2.22
Balance sheet:					
Loans outstanding, net	$ 262,118	$ 252,586	$ 252,882	$ 250,391	$ 230,172
Deposits	292,194	287,546	262,715	241,038	211,865
Total Equity	20,246	24,769	24,287	23,039	16,907
Total Assets	324,573	330,503	314,395	301,207	269,262
Annual Growth - Total Assets	(1.79) %	5.12 %	4.38 %	11.86 %	10.90 %
Operating Ratios:					
Return on average assets	1.01 %	0.93 %	1.09 %	1.28 %	1.16 %
Net interest margin (2)	3.99	3.78	4.13	4.13	3.95
Equity Ratio:					
Return on average shareholder's equity	14.43 %	12.41 %	14.11 %	19.82 %	17.08 %
Equity to assets	6.24	7.49	7.73	7.65	6.28

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(1) Accumulated other comprehensive (loss) income
(2) As a percent of average earning assets

HERITAGE BANCSHARES, INC. (AN S CORPORATION) AND SUBSIDIARY
AUDITED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2022

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INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders
Heritage Bancshares, Inc.
White Hall, West Virginia

Opinion

We have audited the accompanying consolidated financial statements of Heritage Bancshares, Inc. and its subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2022 and 2021; 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, 2022, 2021 and 2020; and the related notes to the consolidated financial statements (collectively, the financial statements).

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the results of its operations and its cash flows for the three years in the period ended December 31, 2022, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date that the financial statements are issued or available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and, therefore, is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

S. R. Snodgrass, P.C., d/b/a S.R. Snodgrass, A.C.

Cranberry Township, Pennsylvania
March 9, 2023

HERITAGE BANCSHARES, INC. (AN S CORPORATION) AND SUBSIDIARY
CONSOLIDATED BALANCE SHEET

		December 31,	
		2022	2021
ASSETS			
Cash and due from banks	$	5,307,152	$ 23,692,781
Federal funds sold		24,175	122,414
Total cash and cash equivalents		5,331,327	23,815,195
Certificates of deposit		100,000	100,000
Investment securities available for sale		35,076,100	35,383,142
Loans		267,246,396	257,649,133
Less allowance for loan losses		(5,128,261)	(5,063,452)
Net loans		262,118,135	252,585,681
Bank premises and equipment, net		13,332,675	9,251,524
Bank-owned life insurance		6,350,630	6,213,498
Federal Home Loan Bank stock		442,400	618,700
Accrued interest receivable		876,901	856,157
Other assets		944,530	1,679,130
TOTAL ASSETS	$	324,572,698	$ 330,503,027
LIABILITIES			
Deposits:			
Noninterest-bearing demand	$	73,154,667	$ 68,006,494
Interest-bearing demand		219,039,334	219,539,326
Total deposits		292,194,001	287,545,820
Short-term borrowings		3,539,200	-
Subordinated debentures owed to unconsolidated subsidiary trust		5,671,000	5,671,000
Long-term borrowings		438,558	10,599,703
Other liabilities		2,484,074	1,917,670
TOTAL LIABILITIES		304,326,833	305,734,193
SHAREHOLDERS’ EQUITY			
Common stock			
Par value $.50 per share; authorized 5,600,000 shares in 2022 and 2021; issued 1,383,575 shares in 2022 and 2021; 1,207,964 shares outstanding in 2022 and 2021		691,788	691,788
Capital surplus		4,649,445	4,649,445
Retained earnings		22,610,294	21,246,973
Treasury stock, at cost, 175,611 shares in 2022 and 2021		(1,874,657)	(1,874,657)
Accumulated other comprehensive (loss) income		(5,831,005)	55,285
TOTAL SHAREHOLDERS’ EQUITY		20,245,865	24,768,834
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$	324,572,698	$ 330,503,027

See accompanying notes to the consolidated financial statements.

HERITAGE BANCSHARES, INC. (AN S CORPORATION) AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31, 2022	2021	2020
INTEREST INCOME			
Interest and fees on loans:			
Taxable	$ 12,300,545	$ 12,508,200	$ 13,744,320
Tax-exempt	23,282	37,743	53,077
Interest and dividends on securities:			
Taxable	894,701	391,469	500,796
Interest on federal funds sold	53,936	29,767	28,516
Interest on certificates of deposit	1,837	225	520
Total interest income	13,274,301	12,967,404	14,327,229
INTEREST EXPENSE			
Interest expense on deposits	1,089,226	1,682,544	2,229,886
Other interest	287,056	419,226	654,991
Total interest expense	1,376,282	2,101,770	2,884,877
NET INTEREST INCOME	11,898,019	10,865,634	11,442,352
Provision for loan losses	612,500	1,548,500	1,120,500
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	11,285,519	9,317,134	10,321,852
OTHER OPERATING INCOME			
Service fees on deposits	1,589,433	1,377,089	1,309,414
Insurance commissions	121	9,261	11,728
Earnings on bank-owned life insurance	137,132	138,940	143,787
Gain (loss) on sale of other real estate owned	-	9,679	(74,535)
(Loss) gain on disposal of premises and equipment	(188,658)	39,584	(640)
Other	178,428	77,742	72,643
Total other operating income	1,716,456	1,652,295	1,462,397
OTHER OPERATING EXPENSES			
Salaries and employee benefits	4,707,069	3,278,967	3,891,295
Net occupancy expense	315,362	314,930	279,713
Equipment rentals, depreciation, and maintenance	1,131,640	1,079,921	1,116,536
Professional fees	330,689	259,896	251,411
Computer expense	1,432,885	1,338,594	1,173,422
FDIC assessment	180,587	146,396	140,132
Other	1,607,679	1,495,247	1,550,874
Total other operating expenses	9,705,911	7,913,951	8,403,383
NET INCOME	$ 3,296,064	$ 3,055,478	$ 3,380,866
EARNINGS PER SHARE	$ 2.73	$ 2.53	$ 2.79
AVERAGE SHARES OUTSTANDING	1,207,820	1,207,938	1,209,670

See accompanying notes to the consolidated financial statements.

HERITAGE BANCSHARES, INC. (AN S CORPORATION) AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

	Year Ended December 31,		
	2022	2021	2020
Net income	$ 3,296,064	$ 3,055,478	$ 3,380,866
Other comprehensive (loss) income:			
(Decrease) increase in net unrealized gains and losses on available-for-sale securities	(5,886,290)	(522,192)	397,103
Other comprehensive (loss) income	(5,886,290)	(522,192)	397,103
Comprehensive (loss) income	$ (2,590,226)	$ 2,533,286	$ 3,777,969

See accompanying notes to the consolidated financial statements.

HERITAGE BANCSHARES, INC. (AN S CORPORATION) AND SUBSIDIARY
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

	Common Stock	Capital Surplus	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2019	$ 691,788	$ 4,618,016	$ 19,306,179	$ (1,757,577)	$ 180,374	$ 23,038,780
Net income	-	-	3,380,866	-	-	3,380,866
Dividends declared ($2.02 per share)	-	-	(2,442,012)	-	-	(2,442,012)
Sale of treasury stock (2,000 shares)	-	29,580	-	20,420	-	50,000
Purchase of treasury stock (5,500 shares)	-	-	-	(137,500)	-	(137,500)
Other comprehensive income	-	-	-	-	397,103	397,103
Balance, December 31, 2020	$ 691,788	$ 4,647,596	$ 20,245,033	$ (1,874,657)	$ 577,477	$ 24,287,237
Net income	-	-	3,055,478	-	-	3,055,478
Dividends declared ($1.70 per share)	-	-	(2,053,538)	-	-	(2,053,538)
Sale of treasury stock (493 shares)	-	10,373	-	5,034	-	15,407
Purchase of treasury stock (493 shares)	-	(8,524)	-	(5,034)	-	(13,558)
Other comprehensive loss	-	-	-	-	(522,192)	(522,192)
Balance, December 31, 2021	$ 691,788	$ 4,649,445	$ 21,246,973	$ (1,874,657)	$ 55,285	$ 24,768,834
Net income	-	-	3,296,064	-	-	3,296,064
Dividends declared ($1.60 per share)	-	-	(1,932,743)	-	-	(1,932,743)
Sale of treasury stock (2,065 shares)	-	-	-	60,015	-	60,015
Purchase of treasury stock (2,065 shares)	-	-	-	(60,015)	-	(60,015)
Other comprehensive loss	-	-	-	-	(5,886,290)	(5,886,290)
Balance, December 31, 2022	$ 691,788	$ 4,649,445	$ 22,610,294	$ (1,874,657)	$ (5,831,005)	$ 20,245,865

See accompanying notes to the consolidated financial statements.

HERITAGE BANCSHARES, INC. (AN S CORPORATION) AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2022	2021	2020
OPERATING ACTIVITIES			
Net income	$ 3,296,064	$ 3,055,478	$ 3,380,866
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	677,019	635,981	666,501
Provision for loan losses	612,500	1,548,500	1,120,500
Loss (gain) on disposal of premises and equipment	188,658	(39,584)	640
(Gain) loss on sale of other real estate owned	-	(9,679)	74,535
(Increase) decrease in accrued interest receivable	(20,744)	422,671	(475,683)
Amortization of security premiums and accretion of discounts, net	214,783	548,295	252,131
Earnings on bank-owned life insurance	(137,132)	(138,940)	(143,787)
Write-down of other real estate owned	-	13,568	110,262
Decrease (increase) in other assets	734,600	(553,020)	(164,603)
Increase (decrease) in other liabilities	493,927	(110,792)	(702,681)
Net cash provided by operating activities	6,059,675	5,372,478	4,118,681
INVESTING ACTIVITIES			
Principal payments received on securities available for sale	7,352,693	16,600,586	8,187,093
Purchases of securities available for sale	(13,146,724)	(28,354,157)	(14,909,750)
Loans made to customers, net	(10,144,954)	(1,309,378)	(3,782,455)
Purchases of premises and equipment	(5,231,302)	(1,364,531)	(199,938)
Sale of premises and equipment	284,474	83,373	1,039
Proceeds from sale of other real estate owned	-	92,579	128,395
Purchase of FHLB stock	(805,100)	(23,700)	(80,900)
Redemption of FHLB stock	981,400	366,100	466,800
Net cash used for investing activities	(20,709,513)	(13,909,128)	(10,189,716)
FINANCING ACTIVITIES			
Net increase of demand deposits, NOW accounts and savings accounts	10,970,030	42,259,497	25,463,473
(Decrease) in time deposits	(6,321,849)	(17,428,729)	(3,785,976)
Proceeds from short-term borrowings	3,539,200	-	-
Principal payments on long-term borrowings	(10,161,145)	(8,755,740)	(9,492,797)
Dividends paid	(1,860,266)	(2,391,769)	(1,984,140)
Purchase of common stock for treasury	60,015	(13,558)	(137,500)
Proceeds from sale of common stock from treasury	(60,015)	15,407	50,000
Net cash used for financing activities	(3,834,030)	13,685,108	10,113,060
(Decrease) increase in cash and cash equivalents	(18,483,868)	5,148,458	4,042,025
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	23,815,195	18,666,737	14,624,712
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 5,331,327	$ 23,815,195	$ 18,666,737
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION			
Cash payments for:			
Interest on deposits and borrowings	$ 1,354,541	$ 2,177,513	$ 2,973,049
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCIAL ACTIVITIES			
Other real estate and repossessed assets acquired in settlement of loans	$ -	$ 57,068	$ 170,880
Dividends declared but unpaid	$ 591,901	$ 519,424	$ 857,655

See accompanying notes to the consolidated financial statements.

HERITAGE BANCSHARES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of business: Heritage Bancshares, Inc. (an S Corporation) (the "Company") is a bank holding company. The subsidiary, First Exchange Bank (the "Bank"), is a commercial bank with locations in Marion County, Wetzel County, and Monongalia County, West Virginia. The Bank provides retail and commercial loan and deposit services to individuals and small businesses in Marion, Wetzel, Monongalia, and the surrounding counties of West Virginia. The Bank is the sole member of First Heritage Insurance Services, LLC, a company incorporated during 2000. First Heritage Insurance Services, LLC had no significant operations during 2022, 2021, and 2020.

Basis of financial statement presentation: The accounting and reporting policies of Heritage Bancshares, Inc. (an S Corporation) and its wholly owned subsidiary conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry.

Principles of consolidation: The accompanying consolidated financial statements include the accounts of Heritage Bancshares, Inc. (an S Corporation) and its wholly owned subsidiary, First Exchange Bank, which is also the parent of First Heritage Insurance Services, LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

Variable interest entities: In accordance with ASC Topic 810, business enterprises that represent the primary beneficiary of another entity by retaining a controlling interest in that entity's assets, liabilities, and results of operations must consolidate the entity in its financial statements. The Company has determined that the provisions of ASC Topic 810 require deconsolidation of subsidiary trusts that issued guaranteed preferred beneficial interests in subordinated debentures (trust preferred securities). Heritage Bancshares Statutory Trust I, issued in 2005, has not been consolidated in the Consolidated Balance Sheet. The trust preferred securities continue to qualify as Tier 1 capital for regulatory purposes. The banking regulatory agencies have not issued any guidance that would change the regulatory capital treatment for the trust preferred securities based on the adoption of ASC Topic 810. See Note 9 of the Notes to Consolidated Financial Statements for a discussion of the subordinated debentures.

Accounting estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Subsequent events: For the year ended December 31, 2022, we evaluated subsequent events through March 9, 2023.

Presentation of cash flows: For purposes of reporting cash flows, cash and due from banks includes cash on hand and noninterest-bearing balances due from banks (including cash items in process of clearing) and federal funds sold. Cash flows from demand deposits, NOW accounts, savings accounts, interest-bearing deposits, and short-term borrowings are reported net, since their original maturities are less than three months. Cash flows from loans and certificates of deposits and other time deposits are reported net.

Securities: Securities classified as held to maturity, available for sale, or trading at the time of purchase of each security and are reevaluated at each reporting date.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The appropriate classification is determined as follows:

Securities held to maturity: Debt securities for which the Bank has the positive intent and ability to hold to maturity are reported at cost and are adjusted for amortization of premiums and accretion of discounts that are recognized using the interest method.

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

Trading securities: There are no securities classified as trading in the accompanying consolidated financial statements.

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

Loans and allowance for loan losses: Loans are stated at the amount of unpaid principal and are reduced by an allowance for loan losses. For all loans, interest is accrued daily on the outstanding balances.

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

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

Loans are placed on nonaccrual status when management believes that the borrower's financial condition, after giving consideration to economic and business conditions and collection efforts, is such that collection of interest is doubtful. Interest is accrued daily on impaired loans unless the loan is placed on nonaccrual status. Impaired loans are placed on nonaccrual status when the payments of principal and interest are in default for a period of 90 days, unless the loan is both well secured and in the process of collection. Interest on nonaccrual loans is recognized primarily using the cost-recovery method. Loans may be returned to accrual status when repayment is reasonably assured and there has been demonstrated performance under the terms of the loan or if applicable, the terms of the restructured loans.

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

Other real estate owned: Other real estate owned consists primarily of real estate held for resale, which was acquired through foreclosure on loans secured by such real estate. At the time of acquisition, these properties are recorded at the lower of cost or estimated fair value with any write-down being charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are recorded to loss on foreclosed real estate as incurred.

Foreclosed assets acquired in settlement of loans carried at fair value less estimated costs to sell are included in the other assets on the Consolidated Balance Sheet. As of December 31, 2022, and 2021, a total of $84,887, of residential real estate foreclosed assets were included in other assets. As of December 31, 2022, the Company has initiated no formal foreclosure procedures on consumer residential mortgages.

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

Employee benefits: The Bank has a contributory pension plan that covers substantially all employees. Pension costs are approved by the Board of Directors and charged to expense.

Income taxes: The Company elected S Corporation status effective January 1, 2009. As an S Corporation, the earnings and losses after that date will be included in the personal income tax returns of the shareholders and taxed depending on their personal tax strategies. Accordingly, the Company will not incur additional income tax obligations, and financial statements will not include a provision for income taxes.

The Company recognizes and measures its unrecognized tax benefits in accordance with FASB ASC 740, *Income Taxes*. Under the guidance, the Company assesses the likelihood, based on their technical merit, that tax positions will be sustained upon examination, based on the facts, circumstances, and information available at the end of each period. The measurement of unrecognized tax benefits is adjusted when new information is available or when an event occurs that requires change. There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Company recognizes, when applicable, interest and penalties related to the unrecognized tax benefits in other expenses on the Consolidated Statements of Income. The Company's federal and state income tax returns for taxable years ended prior to 2018 are closed for purposes of examination by the Internal Revenue Service and state taxing authorities.

Earnings per share: Basic earnings per common share are computed based upon the weighted-average shares outstanding. The weighted-average shares outstanding were 1,207,820 for 2022, 1,207,938 for 2021, and 1,209,670 for 2020. During the years ended December 31, 2022, 2021, and 2020, the Company did not have any potentially dilutive securities.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash surrender value of life insurance: The Company owns insurance on the lives of a certain group of key employees. The policies were purchased to help offset the increase in the costs of various fringe benefit plans including health care. The cash surrender value of these policies is included as an asset on the Consolidated Balance Sheet, and any increases in the cash surrender value are recorded as noninterest income on the Consolidated Statements of Income. In the event of the death of an insured individual under these policies, the Company would receive a death benefit, which would be recorded as noninterest income.

Comprehensive income (loss): The Company is required to present comprehensive income (loss) and its components in a full set of general-purpose financial statements for all periods presented. Other comprehensive income (loss) comprises unrealized holding gains and losses on the available-for-sale securities portfolio.

Transfers of financial assets: Transfers of financial assets, including loan and loan participation sales, are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when: (1) the assets have been isolated from the Bank; (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Advertising: Advertising costs are expensed as incurred.

Employee Retention Credit: The Company qualified for federal government assistance during the year ended December 31, 2021, in the amount of $634,562 through the Employee Retention Credit provisions of the Consolidated Appropriations Act of 2022. The purpose of the Employee Retention Credit is to encourage employers to keep employees on the payroll, even if they are not working during the covered period due to the effects of the coronavirus outbreak. These funds were recorded in the Consolidated Statements of Income as an offset to payroll costs in their respective expense lines and as a receivable on the Consolidated Balance Sheet as of December 31, 2021. The Company received payments totaling $617,034 for the Employee Retention Credit as of December 31, 2022.

Reclassifications: Certain amounts in the consolidated financial statements, such as reclassification, had no effect on net income or shareholders' equity, as previously presented, and have been reclassified to conform to current-year classifications.

Significant Authoritative Guidance

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, *Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments*, which changes the impairment model for most financial assets. This standard, along with several other subsequent codification updates, replaces the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses that are expected to occur over the remaining life of a financial asset and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments in this update require a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The new current expected credit losses model ("CECL") will apply to the allowance for loan losses, available-for-sale and held-to-maturity debt securities, purchased financial assets with credit deterioration and certain off-balance sheet credit exposures.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Significant Authoritative Guidance (Continued)

Management has completed its implementation plan, segmentation and testing, and model validation. The implementation plan included drafting of additional controls and policies to govern data uploads to its third-party vendor, balancing and reconciling, testing and auditing of inputs, and review and decision-making surrounding segmentation, methodologies, qualitative factor adjustments, and reasonable and supportable forecasts and reversion techniques. Parallel runs were processed during 2022 and the results were consistent with management's expectations. The implementation plan is currently going through the Company's control structure and internal control testing is being performed.

The Company will adopt ASU 2016-13 in the first quarter of 2023. The Company does not expect the adoption of this standard to have a material impact on its consolidated financial statements.

In January 2020, the FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting, March 2020,* to provide temporary optional expedients and exceptions to the U.S. GAAP guidance on contract modifications and hedge accounting to ease the financial reporting burdens of the expected market transition from LIBOR and other interbank-offered rates to alternative reference rates, such as the Secured Overnight Financing Rate. Entities can elect not to apply certain modification accounting requirements to contracts affected by what the guidance calls “reference rate reform” if certain criteria are met. An entity that makes this election would not have to remeasure the contracts at the modification date or reassess a previous accounting determination. Also, entities can elect various optional expedients that would allow them to continue applying hedge accounting for hedging relationships affected by reference rate reform if certain criteria are met, and can make a one-time election to sell and/or reclassify held-to-maturity debt securities that reference an interest rate affected by reference rate reform. The amendments in this ASU are effective for all entities upon issuance through December 31, 2022. In December 2022, the FASB issued ASU 2022-06, *Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848*, which extends the sunset (or expiration) date of Accounting Standards Codification (ASC) Topic 848 to December 31, 2024. This gives reporting entities two additional years to apply the accounting relief provided under ASC Topic 848 for matters related to reference rate reform. ASU 2022-06 is effective for all reporting entities immediately upon issuance and must be applied on a prospective basis. This Update is not expected to have a significant impact on the Company's financial statements.

2. REVENUE RECOGNITION

The core principle of Topic 606 is that an entity recognize revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to a customer. Topic 606 requires entities to exercise more judgment when considering the terms of a contract under Topic 605, *Revenue Recognition*. Topic 606 applies to all contracts with customers to provide goods or services in the ordinary course of business, except for contracts that are specifically excluded from its scope. Topic 606 does not apply to revenue associated with interest income on financial instruments, including loans and securities. Additionally, certain noninterest income streams such as income from bank-owned life insurance and gain and losses on sales of debt and equity securities are out of scope of Topic 606. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation beyond what is presented in the Consolidated Statements of Income was not necessary.

Service Fees on Deposits

Topic 606 is applicable to noninterest revenue streams, such as service charges on deposit accounts, which consists of monthly service fees, wire transfer fees, ATM fees, and other deposit account related fees. The Company's performance obligation for account analysis fees and monthly service fees is generally satisfied and the related revenue recognized over the period in which the service is provided. Other deposit account related fees are largely transactional based and, therefore, revenue is recognized upon completion of transaction.

Other Income

Other income within the scope of Topic 606 is primarily comprised of credit life insurance commissions and safe deposit box rents. Credit life insurance commissions are recognized over time using the monthly outstanding balance method that corresponds to the underlying insurance policy period for which the Company is obligated to perform under contract with the insurance carrier. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Company determined that since rentals and renewals occur consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation.

Gain on Sale of Other Real Estate Owned (OREO)

The Bank records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of delivery of an executed deed. When the Bank finances the sale of OREO to the buyer, management assesses whether the buyer is committed to perform the buyer's obligation under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Bank adjusts the transaction price and related gain (loss) on sale if a significant financing component is present.

3. INVESTMENT SECURITIES AVAILABLE FOR SALE

The amortized cost, unrealized gains, unrealized losses, and fair values of investment securities are as follows:

	2022			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies and corporations	$ 2,201,322	$ -	$ (563,347)	$ 1,637,975
Mortgage-backed securities - U.S. government agencies and corporations	38,676,110	2,442	(5,240,427)	33,438,125
Total available for sale	$ 40,877,432	$ 2,442	$ (5,803,774)	$ 35,076,100

	2021			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agencies and corporations	$ 2,197,625	$ -	$ (49,509)	$ 2,148,116
Mortgage-backed securities - U.S. government agencies and corporations	33,100,559	328,315	(193,848)	33,235,026
Total available for sale	$ 35,298,184	$ 328,315	$ (243,357)	$ 35,383,142

Impairment is evaluated considering numerous factors, and their relative significance varies case to case. Factors considered include the length of time and extent to which the market value has been less than cost, the financial condition and near-term prospects of the issuer, and the ability and intent to retain the security until recovery.

The Company has 142 and 8 securities in an unrealized loss position at December 31, 2022 and 2021, respectively. The unrealized losses are due to overall increases in market interest rates and not underlying credit concerns of the issuers. The Company has the ability and intent to hold such investments until maturity or market price recovery. Accordingly, the Company has concluded that none of the securities in its investment portfolio are other-than-temporarily impaired at December 31, 2022 and 2021.

3. INVESTMENT SECURITIES AVAILABLE FOR SALE (Continued)

The following tables show the Company's gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at December 31, 2022 and 2021.

	2022					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agencies and corporations	$ -	$ -	$ 1,637,975	$ (563,347)	$ 1,637,975	$ (563,347)
Mortgage-backed securities - U.S. government agencies and corporations	17,497,884	(2,115,278)	15,940,241	(3,125,149)	33,438,125	(5,240,427)
Total	$ 17,497,884	$ (2,115,278)	$ 17,578,216	$ (3,688,496)	$ 35,076,100	$ (5,803,774)

	2021					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agencies and corporations	$ 2,148,116	$ (49,509)	$ -	$ -	$ 2,148,116	$ (49,509)
Mortgage-backed securities - U.S. government agencies and corporations	18,765,256	(185,351)	725,194	(8,497)	19,490,450	(193,848)
Total	$ 20,913,372	$ (234,860)	$ 725,194	$ (8,497)	$ 21,638,566	$ (243,357)

Mortgage-backed obligations of U.S. government agencies and corporations are included in securities at December 31, 2022 and 2021. These obligations, having contractual remaining lives to maturities ranging from less than a year to 30 years, are reflected in the following maturity distribution schedules. Accordingly, discounts are accreted and premiums are amortized over the anticipated average life to maturity of the specific obligation. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due in one year or less	$ 4,830	$ 4,546
Due after one year through five years	985,839	920,031
Due after five years through ten years	4,781,960	4,361,833
Due after ten years	35,104,803	29,789,690
Total	$ 40,877,432	$ 35,076,100

Securities carried at amortized costs of $4,283,352 and $339,758 at December 31, 2022 and 2021, respectively, with estimated fair values of $3,701,194 and $413,436, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

4. LOANS

Major classifications of loans are summarized by portfolio segment as follows:

	2022	2021
Commercial	$ 24,368,947	$ 27,954,868
Commercial, financial, and agricultural - secured by real estate	96,131,054	92,880,987
Consumer loans	9,053,155	9,086,884
Consumer real estate	137,693,240	127,726,394
	267,246,396	257,649,133
Less: Allowance for loan losses	5,128,261	5,063,452
Net loans	$ 262,118,135	$ 252,585,681

The following table presents the nonaccrual loans, by class, included in the net balance of loans at December 31, 2022 and 2021:

	2022	2021
Commercial	$ 382,888	$ 119,522
Commercial real estate		
Construction	-	-
Other	3,469,417	4,073,043
Consumer loans		
Auto	64,672	65,381
Other	25,181	32,492
Consumer real estate	1,507,499	1,922,444
Net loans	$ 5,449,657	$ 6,212,882

During 2021, the Company participated in the Paycheck Protection Program (PPP), administered directly by the U.S. Small Business Administration (SBA). The PPP provides loans to small businesses that were affected by economic conditions as a result of COVID-19 to provide cash-flow assistance to employers who maintain their payroll (including healthcare and certain related expenses), mortgage interest, rent, leases, utilities, and interest on existing debt during the COVID-19 emergency. As of December 31, 2022, the Company has no outstanding principal balances of PPP loans, and as of December 31, 2021, the Company had outstanding principal balances of $2.2 million. The PPP loans are fully guaranteed by the SBA and may be eligible for forgiveness by the SBA to the extent that the proceeds are used to cover eligible payroll costs, interest costs, rent, and utility costs over a period of up to 24 weeks after the loan is made as long as certain conditions are met regarding employee retention and compensation levels. PPP loans deemed eligible for forgiveness by the SBA will be repaid by the SBA to the Company. PPP loans are included in the commercial loan category.

In accordance with the SBA terms and conditions on these PPP loans, the Company received approximately $0 and $247,744 in fees associated with the processing of these loans in 2022 and 2021, respectively. Upon funding of the loan, these fees were recognized immediately, whereas ASC Topic 310 requires that such fees and costs be deferred and amortized as adjustments of the related loan's yield over the contractual life of the loan. The Company's method of recognition of loan fees and direct loan costs produces results that are not materially different from those that would have been recognized had ASC Topic 310 been adopted.

5. ALLOWANCE FOR LOAN LOSSES

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Company has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: consumer real estate, commercial real estate loans, commercial loans, and consumer loans. Historical loss percentages for each risk category are calculated and used as the basis for calculating allowance allocations. These historical loss percentages are calculated over a three-year period for all portfolio segments.

Certain qualitative factors are then added to the historical allocation percentage to get the adjusted factor to be applied to nonclassified loans.

The qualitative factors are reviewed each quarter and adjusted based upon relevant changes within the portfolio. During 2022, the reserves for commercial real estate, consumer, and consumer real estate loans increased. These increases were a result of increases to the calculation of qualitative factors and increases in specific reserves associated with impaired loans during the period. There was a decrease to commercial loans due to a reduction in loan balances. During 2021, the reserves for commercial, consumer, and consumer real estate loans increased. These increases were also a result of increases to the calculation of qualitative factors and increases in specific reserves associated with impaired loans during the period. Also, an increase in the consumer real estate provision was due to an increase in charge-offs during the period. During 2020, the reserves for commercial real estate, consumer, and consumer real estate loans increased. These increases were a result of increases to the calculation qualitative factors to account for the impact of the COVID-19 pandemic on local customers. Although there was significant loan growth in the commercial non-real estate bucket, it was noted that the growth in this bucket was a result of PPP loan growth during the year. These loans are fully guaranteed by the SBA and were not included in the allowance calculation. Charge-offs over the period decreased for all loan buckets with the exception of the commercial non-real estate bucket. Changes in the allowance for loan losses for the years ended 2022, 2021, and 2020 by loan portfolio segment are as follows:

	2022				
	Commercial	Commercial Real Estate	Consumer	Consumer Real Estate	Total
Allowance for loan losses:					
Beginning balance	$ 1,010,647	$ 1,331,604	$ 820,313	$ 1,900,888	$ 5,063,452
Charge-offs	-	(89,472)	(140,507)	(368,280)	(598,259)
Recoveries	7,222	1,898	33,466	7,982	50,568
Provision (credit)	(510,958)	515,891	109,486	498,081	612,500
Ending balance	$ 506,911	$ 1,759,921	$ 822,758	$ 2,038,671	$ 5,128,261

	2021				
	Commercial	Commercial Real Estate	Consumer	Consumer Real Estate	Total
Allowance for loan losses:					
Beginning balance	$ 481,949	$ 1,653,223	$ 791,186	$ 1,373,547	$ 4,299,905
Charge-offs	-	(104,395)	(105,832)	(662,829)	(873,056)
Recoveries	5,284	2,200	53,513	27,106	88,103
Provision (credit)	523,414	(219,424)	81,446	1,163,064	1,548,500
Ending balance	$ 1,010,647	$ 1,331,604	$ 820,313	$ 1,900,888	$ 5,063,452

5. ALLOWANCE FOR LOAN LOSSES (Continued)

	2020				
	Commercial	Commercial Real Estate	Consumer	Consumer Real Estate	Total
Allowance for loan losses:					
Beginning balance	$ 492,819	$ 1,437,820	$ 470,184	$ 1,069,507	$ 3,470,330
Charge-offs	(19,978)	(86,995)	(189,915)	(119,463)	(416,351)
Recoveries	23,789	11,456	77,343	12,838	125,426
(Credit) provision	(14,681)	290,942	433,574	410,665	1,120,500
Ending balance	$ 481,949	$ 1,653,223	$ 791,186	$ 1,373,547	$ 4,299,905

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the Consolidated Balance Sheet date. The Company considers the allowance for loan losses of $5,128,261 and $5,063,452 adequate to cover loan losses inherent in the loan portfolio at December 31, 2022 and 2021, respectively. The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31:

	2022				
	Commercial	Commercial Real Estate	Consumer	Consumer Real Estate	Total
Allowance for loan losses:					
Individually evaluated for impairment	$ 29,409	$ 1,023,243	$ 6,508	$ 156,952	$ 1,216,112
Collectively evaluated for impairment	477,502	736,678	816,250	1,881,719	3,912,149
Total	$ 506,911	$ 1,759,921	$ 822,758	$ 2,038,671	$ 5,128,261
Loans:					
Individually evaluated for impairment	$ 444,228	$ 9,276,286	$ 61,783	$ 3,334,345	$ 13,116,642
Collectively evaluated for impairment	23,924,719	86,854,768	8,991,372	134,358,895	254,129,754
Total	$ 24,368,947	$ 96,131,054	$ 9,053,155	$ 137,693,240	$ 267,246,396

5. ALLOWANCE FOR LOAN LOSSES (Continued)

	2021				
	Commercial	Commercial Real Estate	Consumer	Consumer Real Estate	Total
Allowance for loan losses:					
Individually evaluated for impairment	$ 532,820	$ 598,861	$ 8,874	$ 35,358	$ 1,175,913
Collectively evaluated for impairment	477,827	732,743	811,439	1,865,530	3,887,539
Total	$ 1,010,647	$ 1,331,604	$ 820,313	$ 1,900,888	$ 5,063,452
Loans:					
Individually evaluated for impairment	$ 3,572,416	$ 5,968,835	$ 29,352	$ 2,227,919	$ 11,798,522
Collectively evaluated for impairment	24,382,452	86,912,152	9,057,532	125,498,475	245,850,611
Total	$ 27,954,868	$ 92,880,987	$ 9,086,884	$ 127,726,394	$ 257,649,133

Credit Quality Information

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

GRADE 1 (Superior)
Loans in this category are considered to be of the highest quality. The customer's financial performance provides substantial asset protection. Cash flow is continually very high, relative to all demand. Earnings are always very strong, stable, or increasing, even through economic swings. Leverage, including operating leverage, is very low, relative to the borrower's industry and is stable or decreasing. Overall asset quality is very strong.

GRADE 2 (Excellent)
Loans in this category are considered to be of excellent quality. The borrower is very liquid. Overall, leverage is relatively low and is stable or declining. Cash flow is more than sufficient to meet total demands. Earnings are very strong and stable, but the rate of growth may differ from year to year.

GRADE 3 (Very Good)
Loans graded 3 are of very good quality. These borrowers have a history of successful performance, but may be susceptible to economic changes. Asset quality is very good. The balance sheet shows good liquidity, and overall leverage is normal for the industry in which the borrower operates and is stable. Cash flow levels may fluctuate, but are sufficient to meet demands.

GRADE 4 (Good)
Loans in this category, like risk grade 3, are loans of good quality, with risk levels within the Bank's range of acceptability. The borrower's business may be cyclical, or its customer base may be concentrated. Servicing requirements are higher than those for risk grade 3 loans.

5. ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Quality Information (Continued)

GRADE 5 (Fair)
Loans in this grade are considered to have higher than normal credit risk and servicing needs. Accordingly, a higher than market return is expected. Asset quality is marginally acceptable. Overall leverage may fluctuate, but is not highly volatile, and is frequently at the upper end of the range of what is considered normal for the industry. Cash flow may be marginal, but continues to support operating needs. Cash flow is not considered to be highly volatile. The borrower's profitability trend is favorable and the outlook for continued improvement is good. Companies or borrowers in this category would have limited access to other financing sources (to a few banks and/or asset base lenders) and usually at a premium price. Full guaranties on loans to closely held businesses in this risk grade are always required. Collateral is required on all loans, and advances up to the maximum loan to value per policy are often needed.

GRADE 6 (Management Attention)
Loans in this category are considered to have high credit risk and servicing needs. Loans should be in this category, not because they are problem credits, but because they pose a relatively high risk and the Bank needs to follow their performance more closely than other credits with better risk ratings. The borrowers' ability to repay from the primary repayment sources is marginally adequate and is not clearly sufficient to ensure continued performance as contracted. Loans to borrowers in this category are currently performing as contracted, and secondary repayment sources are clearly sufficient to protect against the risk of principal or income loss. It is also reasonable to expect that the circumstances causing repayment capacity to be uncertain will be resolved within six to nine months. Access to alternative financing sources exist, though may be limited to institutions specializing in high-risk financing. Borrowers in this category may have a long-term satisfactory repayment history (i.e., more than 12 consecutive months with no 30+ days past-due status), but financial information is dated, or there is a delay in receiving financials. Borrowers in this category may be operating in an industry that is highly susceptible to downturns in the national or local economies.

GRADE 7 (Special Mention)
Customer's financial condition and position are often unstable. Industry conditions are often troubled or in the process of rapid change. The borrower's ability to repay from primary sources is currently adequate but threatened by potential weakness, which is not checked or corrected, resulting in the Bank being inadequately protected against the risk of principal or income loss at some future date. The borrower is highly susceptible to current economic or market conditions that may adversely affect its ability to repay. The cash flow of these borrowers is currently adequately or slightly inadequate and may not improve in the near future.

Borrowers in this category are experiencing adverse operating trends or operating with unusually high financial leverage, thereby increasing the risk of untimely payment, but not to the extent that liquidation of the loan is jeopardized. This category may include borrowers that have filed bankruptcy and are successfully operating under a plan of reorganization that is provided to the Bank with adequate repayment of debt.

GRADE 8 (Substandard)
The Bank is inadequately protected by the current net worth and paying capacity of the customer. Loans in this category are characterized by high debt to worth, negative cash flow, and negative debt service capacity. There is a history of consecutive operating losses and negative cash flow for the business. Customers who have filed bankruptcy and are in the status of initial filing/up to acceptance of reorganization plan are considered Substandard. Collateral securing the debt may be real estate, accounts receivable, inventory, and equipment that have questionable value. Loans in this category may be placed on nonaccrual until such a time as the borrower's financial condition improves. Some loss of principal or income is possible; however, the total amount of such loss should not exceed 25 percent of the outstanding loan balance.

5. ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Quality Information (Continued)

GRADE 9 (Doubtful)
Loans classified in this category are considered partially uncollectible and of such little value that their continuation as bankable assets may not be warranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but the estimate principal loss of a loan in this classification will exceed 25 percent of the outstanding loan balance. Any time a credit is placed in this category, it should also assume nonaccrual status. The collateral values securing loans in this category are not sufficient to completely cover the loss, but until certain pending factors, such as liquidation procedures, merger acquisition, capital injection, or additional collateral is completed, determination of total loss is unknown.

GRADE 10 (Loss)
Loans classified in this category are considered uncollectible and the possibility of recovery is unlikely.

The following tables present the recorded investment in commercial and commercial real estate loans by portfolio segment, which are generally evaluated based upon the internal risk ratings defined above as of December 31, 2022 and 2021. Loans classified as Pass below include loans rated as Management Attention or better.

	2022		
		Commercial Real Estate	
	Commercial	Construction	Other
Pass	$ 23,831,224	$ 4,706,922	$ 84,640,306
Special Mention	-	-	-
Substandard	537,723	-	6,782,867
Doubtful	-	-	-
Loss	-	-	959
Total	$ 24,368,947	$ 4,706,922	$ 91,424,132

	2021		
		Commercial Real Estate	
	Commercial	Construction	Other
Pass	$ 26,903,563	$ 2,629,132	$ 81,562,781
Special Mention	-	-	-
Substandard	1,051,305	2,261,705	6,427,369
Doubtful	-	-	-
Loss	-	-	-
Total	$ 27,954,868	$ 4,890,837	$ 87,990,150

5. ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Quality Information (Continued)

The following tables present performing and nonperforming residential real estate and consumer loans, by class, based on payment activity for the years ended December 31, 2022 and 2021. Payment activity is reviewed by management on a monthly basis to determine how loans are performing. Loans are considered to be nonperforming when they become 90 days past due or are placed on nonaccrual status.

	2022		
	Performing	Nonperforming	Total
Consumer			
Auto	$ 4,938,001	$ 64,672	$ 5,002,673
Other	4,025,301	25,181	4,050,482
Residential	136,185,741	1,507,499	137,693,240
Total	$ 145,149,043	$ 1,597,352	$ 146,746,395

	2021		
	Performing	Nonperforming	Total
Consumer			
Auto	$ 4,170,626	$ 107,809	$ 4,278,435
Other	4,775,957	32,492	4,808,449
Consumer real estate	125,803,950	1,922,444	127,726,394
Total	$ 134,750,533	$ 2,062,745	$ 136,813,278

Loans to related parties: The Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families, and affiliated companies in which they are principal stockholders (commonly referred to as related parties), all of which have been, in the opinion of management, on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others.

The following represents the activity with respect to related-party loans aggregating $60,000 or more to directors and officers and their related business interests during the years ended December 31, 2022 and 2021. Other changes represent additions to and changes in director's status.

	2022	2021
Balance, beginning	$ 2,441,650	$ 4,196,873
Additions	2,012,802	1,577,190
Amount collected	(636,299)	(397,068)
Other	(1,419,777)	(2,935,345)
Balance, ending	$ 2,398,376	$ 2,441,650

Concentrations of credit risk: The Bank grants installment, commercial, and residential loans primarily to customers in Marion, Wetzel, Monongalia, and the surrounding West Virginia counties. Although the Bank strives to maintain a diversified loan portfolio, exposure to credit losses can be adversely impacted by downturns in local economic and employment conditions.

5. ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Quality Information (Continued)

The Bank accepts chattel paper without recourse from various approved businesses, primarily automobile dealerships, within its lending area. The Bank has sole discretion whether to purchase such paper on a case-by-case basis, which is evaluated substantially under the Bank's normal credit underwriting standards and is generally secured by a first lien on the property purchased by the borrower. At December 31, 2022 and 2021, such loans approximated $2,423,933 and $3,532,136, respectively.

The following are tables that include an aging analysis of the recorded investment of past-due loans, by class, at December 31, 2022 and 2021:

	2022						
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater	Total Past Due	Current	Total Loans	Recorded Investment 90 Days or More and Accruing
Commercial	$ 57,278	$ 13,305	$ -	$ 70,583	$ 24,298,364	$ 24,368,947	$ -
Commercial - real estate							
Construction	-	57,334	-	57,334	4,649,588	4,706,922	-
Other	26,220	-	117,266	143,486	91,280,646	91,424,132	-
Consumer							
Auto	52,255	25,773	31,774	109,802	4,892,871	5,002,673	-
Other	33,610	-	6,964	40,574	4,009,908	4,050,482	-
Consumer real estate	669,153	78,404	936,669	1,684,226	136,009,014	137,693,240	-
Total	$ 838,516	$ 174,816	$ 1,092,673	$ 2,106,005	$ 265,140,391	$ 267,246,396	$ -

	2021						
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater	Total Past Due	Current	Total Loans	Recorded Investment 90 Days or More and Accruing
Commercial	$ -	$ -	$ -	$ -	$ 27,954,868	$ 27,954,868	$ -
Commercial - real estate							
Construction	6,901	-	21,305	28,206	4,862,631	4,890,837	-
Other	240,405	52,483	524,565	817,453	87,172,697	87,990,150	-
Consumer							
Auto	77,814	4,226	99,864	181,904	4,096,531	4,278,435	42,428
Other	139,373	31,604	2,028	173,005	4,635,444	4,808,449	-
Consumer real estate	1,179,166	483,233	647,375	2,309,774	125,416,620	127,726,394	-
Total	$ 1,643,659	$ 571,546	$ 1,295,137	$ 3,510,342	$ 254,138,791	$ 257,649,133	$ 42,428

5. ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loans

Management evaluates commercial loans, commercial real estate loans, construction real estate loans, and other loans rated Substandard, Doubtful, or Loss for impairment. The Company will deem a loan to be impaired when, based on current circumstances and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the original contractual terms of the loan. These loans are analyzed to determine whether it is probable that all amounts will not be collected according to the contractual terms of the loan agreement. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees, or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

The following tables include the recorded investment and unpaid principal balances for impaired loans with the associated allowance amount by loan class, if applicable, as of and for the years ended December 31, 2022 and 2021:

	2022				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With a related allowance recorded:					
Commercial	$ 29,409	$ 31,827	$ 29,409	$ 154,985	$ -
Commercial real estate					
Construction	-	-	-	1,333,983	-
Other	4,764,416	5,176,222	1,023,243	4,740,925	35,165
Consumer					
Auto	7,352	7,352	221	3,011	438
Other	14,747	18,031	6,287	16,035	-
Consumer real estate	1,153,558	1,177,683	156,952	1,112,948	55,834
Total	5,969,482	6,411,115	1,216,112	7,361,887	91,437
With no related allowance recorded:					
Commercial	414,819	437,803	-	297,555	25,490
Commercial real estate					
Construction	2,184,159	2,184,159	-	889,173	100,158
Other	2,327,711	2,569,647	-	2,473,995	138,534
Consumer					
Auto	28,195	28,195	-	42,860	-
Other	11,489	11,489	-	9,491	1,180
Consumer real estate	2,180,787	2,381,152	-	2,762,332	91,307
Total	7,147,160	7,612,445	-	6,475,406	356,669
Total impaired loans:					
Commercial	444,228	469,630	29,409	452,540	25,490
Commercial real estate					
Construction	2,184,159	2,184,159	-	2,223,156	100,158
Other	7,092,127	7,745,869	1,023,243	7,214,920	173,699
Consumer					
Auto	35,547	35,547	221	45,871	438
Other	26,236	29,520	6,287	25,526	1,180
Consumer real estate	3,334,345	3,558,835	156,952	3,875,280	147,141
Total	$ 13,116,642	$ 14,023,560	$ 1,216,112	$ 13,837,293	$ 448,106

5. **ALLOWANCE FOR LOAN LOSSES (Continued)**

<u>Impaired Loans</u> (Continued)

	2021				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With a related allowance recorded:					
Commercial	$ 3,510,276	$ 3,674,115	$ 532,820	$ 2,757,229	$ -
Commercial real estate					
Construction	-	-	-	174,671	-
Other	2,082,755	4,245,691	598,861	2,484,426	-
Consumer					
Auto	20,271	17,334	8,874	24,796	-
Other	-	-	-	-	-
Consumer real estate	523,292	292,232	35,358	344,156	-
Total	6,136,594	8,229,372	1,175,913	5,785,278	-
With no related allowance recorded:					
Commercial	62,140	3,753,004	-	676,058	233,851
Commercial real estate					
Construction	-	-	-	50,000	-
Other	3,886,080	8,507,004	-	3,550,997	418,634
Consumer					
Auto	9,081	9,081	-	15,163	534
Other	-	20,271	-	4,198	2,933
Consumer real estate	1,704,627	2,341,232	-	1,734,265	105,340
Total	5,661,928	14,630,592	-	6,030,681	761,292
Total impaired loans:					
Commercial	3,572,416	7,427,119	532,820	3,433,287	233,851
Commercial real estate					
Construction	-	-	-	224,671	-
Other	5,968,835	12,752,695	598,861	6,035,423	418,634
Consumer					
Auto	29,352	26,415	8,874	39,959	534
Other	-	20,271	-	4,198	2,933
Consumer real estate	2,227,919	2,633,464	35,358	2,078,421	105,340
Total	$ 11,798,522	$ 22,859,964	$ 1,175,913	$ 11,815,959	$ 761,292

5. ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loans (Continued)

Included in impaired loans are troubled debt restructurings of $5,683,656 and $7,095,593 at December 31, 2022 and 2021, respectively. The specific allowance for loan loss reserve for loans modified as troubled debt restructurings was $1,077,438 and $1,135,117 as of December 31, 2022 and 2021, respectively.

The allowance for loan losses is maintained at a level considered adequate to provide for the estimate of probable credit losses inherent in the loan portfolio. The allowance is increased by provisions charged to operating expense and reduced by net charge-offs. Loans are charges against the allowance for loan losses when it is believed that collectability is unlikely. Future adjustments may be necessary if there are significant changes in conditions.

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

Specific Reserve for Loans Individually Evaluated
Generally, for purposes of evaluating impairment, commercial loans with a remaining balance of $150,000 or greater and rated as Substandard (8), Doubtful (9), or Loss (10) will be reviewed for impairment. Business loans that meet the definition of a troubled debt restructuring (TDR) will also be classified as an impaired loan, and an ASC 310 (ASC 310 or FAS 114) analysis will be completed. Management reserves the right to classify additional loans as impaired. Generally, the entire credit relationship of commercial loans identified above will be included and considered for impairment, even though the additional loans may remain rated as Special Mention (7) or better. Such loan relationships are identified primarily through the analysis of internal loan evaluations, watch-list and past-due loan reports, and loans adversely classified by regulatory authorities. Each loan so identified is then individually evaluated to determine whether it is impaired – such that, based on current information and events, it is probable that the Bank will be unable to collect all amounts due in accordance with the contractual terms of the underlying loan agreement. Substantially, all of the Bank’s impaired loans are, and historically have been, collateral dependent, meaning repayment of the loan is expected to be provided solely from the sale of the loan’s underlying collateral. For such loans, impairment is measured based on the fair value of the loan’s collateral, which is generally determined utilizing appraisals that are one year old or less. A specific reserve is established in an amount equal to the excess, if any, of the recorded investment in each impaired loan over the fair value of its underlying collateral, less estimated costs to sell.

Quantitative Reserve for Loans Collectively Evaluated
Quantitative reserves relative to each loan pool are calculated by applying the three-year average net loan charge-off rate to the aggregate recorded investment in loans.

Qualitative Reserve for Loans Collectively Evaluated
The Bank considers it necessary to reserve for additional factors for each of the above loan pools for potential risk factors that could result in actual losses. Such qualitative risk factors considered are: (1) changes in national and local economic and business conditions and developments, including the condition of various market segments; (2) changes in the nature and volume of the portfolio; (3) changes in the experience, ability, and depth of lending management and staff; (4) changes in the trend of the volume and severity of past-due and classified loans; and trends in the volume of nonaccrual loans, TDRs, and other loan modifications; (5) changes in the levels and trends in charge-offs and recoveries; (6) changes in the quality of the institution’s loan review system and the degree of oversight by the institution’s Board of Directors; and the experience, ability, and depth of lending management and other relevant staff; (7) the existence and effect of any concentrations of credit, and changes in the level of such concentrations; (8) the effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the institutions current portfolio; (9) change in lending policies and procedures, including underwriting standards and collection, charge-off, and recovery trends, and (10) other analytical procedures that identify divergent trends.

5. ALLOWANCE FOR LOAN LOSSES (Continued)

Troubled Debt Restructuring (TDR)

There was 1 TDR restructured during the 12 months ended December 31, 2022. The following table presents by class the TDRs that were restructured during the 12 months ended December 31, 2022. Generally, the modifications included extensions of the term, modification of the payment terms from principal and interest to interest only for an extended period, or reduction in interest rate. All TDRs are evaluated individually for allowance for loan loss purposes:

	2022		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial	-	$ -	$ -
Commercial real estate			
Construction	-	-	-
Other	1	377,868	377,868
Consumer			
Auto	-	-	-
Other	-	-	-
Residential			
Prime	-	-	-
Subprime	-	-	-
Total	1	$ 377,868	$ 377,868

There were no TDRs restructured during the 12 months ended December 31, 2021 that subsequently defaulted for the year ended December 31, 2022.

6. BANK PREMISES AND EQUIPMENT

Major classifications of Bank premises and equipment are summarized as follows:

	2022	2021
Land	$ 4,475,004	$ 2,928,860
Buildings and improvements	10,345,830	7,730,339
Furniture and equipment	3,654,318	3,338,673
Construction in progress	-	283,112
	18,475,152	14,280,984
Less accumulated depreciation	5,142,477	5,029,460
Bank premises and equipment, net	$ 13,332,675	$ 9,251,524

Depreciation charged to operations was $677,019 in 2022, $635,981 in 2021, and $666,501 in 2020.

7. DEPOSITS

The following is a summary of interest-bearing deposits by type as of December 31, 2022 and 2021:

	2022	2021
NOW and MMDA accounts	$ 80,188,428	$ 75,109,143
Savings accounts	69,927,053	69,184,481
Certificates of deposit	63,678,429	69,610,055
Individual retirement accounts	5,245,424	5,635,647
Total	$ 219,039,334	$ 219,539,326

Time certificates of deposit in denominations of $100,000 or more totaled $33,252,040 and $36,239,270 at December 31, 2022 and 2021, respectively. Interest paid on such time certificates totaled $489,442, $659,809, and $1,129,029 for the years ended December 31, 2022, 2021, and 2020, respectively.

The following is a summary of the maturity distribution of certificates of deposit in amounts of $100,000 or more as of December 31, 2022 and 2021:

	2022	2021
Three months or less	$ 4,399,650	$ 5,992,496
Three through six months	1,653,247	4,698,645
Six through twelve months	15,080,762	13,904,895
Over twelve months	12,118,381	11,643,234
Total	$ 33,252,040	$ 36,239,270

Additionally, time certificates of deposit in denominations of $250,000 or more totaled $12,458,937 and $9,549,812 at December 31, 2022 and 2021, respectively.

A summary of the maturities on time deposits, which includes certificates of deposit and certain individual retirement accounts, for each of the next five years and thereafter follows:

Years Ending December 31,	Amount
2023	$ 40,256,859
2024	10,851,632
2025	10,687,099
2026	3,257,890
2027	3,408,675
Thereafter	461,698
Total	$ 68,923,853

8. BORROWINGS

Federal Home Loan Bank Advances

The Bank is a member of the Federal Home Loan Bank (FHLB) of Pittsburgh. As a member, the Bank obtained an Open Repo Plus Commitment from the FHLB to finance loan growth and/or meet liquidity needs. The maximum credit available under this agreement is equal to 50 percent of the maximum borrowing capacity available, calculated as a percentage of collateral pledged to the FHLB. Any borrowing bears interest at the interest rate posted by the FHLB on the day of the borrowing and is subject to change daily. The interest rate at December 31, 2022 and 2021, was 4.45 and 0.28 percent, respectively. This line of credit is secured by a blanket lien on all unpledged and unencumbered assets of the Bank. The Bank's maximum borrowing capacity under the credit arrangement with the FHLB as of December 31, 2022, was approximately $152.6 million. There were no outstanding balances as of December 31, 2022 and 2021. The Bank also has total outstanding letters of credit at December 31, 2022, with the FHLB of $2,830,000.

8. BORROWINGS (Continued)

The Company has obtained a line of credit from a financial institution in the amount of $5,000,000. The interest rate on this line of credit is equal to the Wall Street Journal Prime with a floor of 4.49 percent. This line of credit is secured by a first lien assignment and security interest in First Exchange Bank's common stock equal to a loan/value of no less than 70 percent. There was no outstanding balance on this line of credit at December 31, 2022 and 2021.

A summary of short-term borrowings as of December 31, 2022, 2021, and 2020, follows:

	2022	
	FHLB Borrowings	Line of Credit
Outstanding at year-end	$ 3,539,200	$ -
Average amount outstanding	807,423	-
Maximum amount outstanding at any month-end	3,539,200	-
Weighted-average interest rate at year-end	4.45 %	- %
Weighted-average interest rate paid during the year	2.95 %	- %

	2021	
	FHLB Borrowings	Line of Credit
Outstanding at year-end	$ -	$ -
Average amount outstanding	4,698	-
Maximum amount outstanding at any month-end	-	-
Weighted-average interest rate at year-end	- %	- %
Weighted-average interest rate paid during the year	0.28 %	- %

	2020	
	FHLB Borrowings	Line of Credit
Outstanding at year-end	$ -	$ -
Average amount outstanding	164,180	-
Maximum amount outstanding at any month-end	-	-
Weighted-average interest rate at year-end	- %	- %
Weighted-average interest rate paid during the year	0.41 %	- %

9. LONG-TERM BORROWINGS

Subordinated debentures: On November 10, 2005, the Company formed Heritage Bancshares Statutory Trust I. The Trust is a 100 percent-owned subsidiary of the Company and exists for the purpose of (1) issuing trust-preferred capital securities (Capital Securities) and (2) using the proceeds from the sale of the Capital Securities to acquire subordinated debentures issued by the Company. The debentures are the sole assets of the Trust and the Company's payments under the debentures are the sole source of revenue of the Trust. Five thousand-five hundred Capital Securities ($1,000 liquidation value per Capital Security) were issued in the aggregate liquidation amount of $5,500,000, and 171 common securities were also issued in the aggregate amount of $171,000.

The Company has irrevocably and unconditionally guaranteed, with respect to the Capital Securities and to the extent not paid by the Trust, accrued and unpaid distributions on the Capital Securities and the redemption price payable to the holders of the Capital Securities. The Company has the option to defer payment of the distributions for an extended period up to five years, so long as the Company is not in default of the terms of the debentures.

9. LONG-TERM BORROWINGS (Continued)

The Capital Securities term is 30 years; however, the Capital Securities and debentures are redeemable, in whole or in part, at any distribution payment date on or after the distribution payment date of December 2011, at the redemption price. In addition, the debentures may be redeemed at a special redemption price, in whole but not in part, at any distribution payment date, upon the occurrence of and continuation of a special event within 120 days following the occurrence of such special event at the special redemption price, upon not less than 30 nor more than 60 days notice to holders of such debentures so long as such special event is continuing. Interest is payable quarterly during the 30-year term. Interest will be equal to the three-month LIBOR plus 1.50 percent. The interest rate at December 31, 2022 and 2021, was 6.27 percent and 1.70 percent, respectively.

FHLB long-term borrowings: As a member of the FHLB, the Bank obtained borrowings from the FHLB under various lending programs to finance loan growth and/or meet liquidity needs as necessary. All such borrowings are secured by a lien on all unpledged and unencumbered assets of the Bank.

A summary of the Company's FHLB borrowings at December 31, 2022 and 2021, follows:

	2022	2021
Interest due monthly. The borrowing matures January 2023.	$ 24,253	$ 150,699
Note payable, dated January 2019, to FHLB at 2.96 percent. Interest due monthly. The borrowing matures January 2024.	275,404	310,849
Note payable, dated January 2019, to FHLB at 2.99 percent. Interest due monthly. The borrowing matures January 2024.	-	521,839
Note payable, dated April 2019, to FHLB at 2.52 percent. Interest due monthly. The borrowing matures May 2022.	-	279,524
Note payable, dated April 2019, to FHLB at 2.51 percent. Interest due monthly. The borrowing matures May 2023.	138,901	466,226
Note payable, dated August 2019, to FHLB at 1.87 percent. Interest due monthly. The borrowing matures August 2023.	-	8,870,566
	$ 438,558	$ 10,599,703

A summary of the maturities of FHLB borrowings over the next five years follows:

Years Ending December 31,	Amount
2023	$ 416,997
2024	21,561
Total	$ 438,558

10. LEASES

The Company leases land, building, and equipment under various noncancelable operating lease agreements. These noncancelable operating leases are subject to renewal options under various terms. Rent expense under noncancelable operating leases approximated $42,585, $102,204, and $102,204 for the years ended December 31, 2022, 2021, and 2020, respectively.

Future minimum payment under noncancelable operating leases with initial or remaining terms of one year or more as of December 31, 2022, was $0. There are no future minimum payments beyond 2022.

11. COMMITMENTS AND CONTINGENT LIABILITIES

Financial Instruments with Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the accompanying consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

Financial Instruments Whose Contract Amounts Represent Credit Risk	Contract Amount 2022	Contract Amount 2021
Commitments to extend credit	$ 15,534,647	$ 11,019,387
Unused open business lines of credit	9,457,240	9,352,802
Unused open home equity and personal lines of credit	6,114,080	5,722,720
Standy letters of credit and financial guarantees	55,000	55,000
Remaining commitments on constrution loans	8,034,974	7,214,200
Overdraft protection commitments	5,240,150	5,228,316
Total	$ 44,436,091	$ 38,592,425

The Bank implemented an overdraft privilege product to qualified individual transaction account holders providing automatic payment of overdrafts up to a specified amount based on the type of account, charging the standard overdraft fee.

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

Contingent Liabilities

Due to the nature of the Bank's business, which involves the collection of loans and the enforcement and validity of liens, security interests and mortgages, the Bank is plaintiff in various routine legal proceedings, the outcome of which is not expected to have a material effect on the Company's financial position.

Employment Contracts

The Company and its subsidiary have employment contracts with certain executive officers. Under the terms of these agreements, each officer has the option to terminate employment in the event of a merger or the acquisition of the Company or the Bank by another financial institution or company, and receive cash payments, plus health benefits, for periods specified, in the agreements. The aggregate estimated commitment under these agreements approximated $696,897 and $947,611 at December 31, 2022 and 2021, respectively.

12. EMPLOYEE BENEFITS

The Bank maintains a voluntary retirement savings plan that is comprised of two components; the employee Stock Ownership and 401(k) Plan (KSOP). The KSOP benefits employees with at least six months of service, who are 20½ years of age or older. The Bank may fund the ESOP with contributions of cash or stock, and may fund the 401(k) Plan with contributions of cash. Participation in the plan is available upon attaining the age of 20½ years and completion of six months service. Participants are permitted to contribute up to the maximum dollar amount allowed by the Internal Revenue Service, which is $20,500 for 2022. The Bank matches contributions made by the participants on a dollar-for-dollar basis, up to a maximum of 5 percent of the employee's compensation. In addition, the Bank may elect to make additional contributions, as prescribed by the Plan, not to exceed certain limitations by the Internal Revenue Service regulations.

The participants' contributions are fully vested upon payment while the employer portions are subject to certain vesting requirements if an employee terminates prior to normal retirement age. Employer contributions are fully vested after six years. Plan participants are entitled to receive Plan benefits upon termination of employment, death, disability, or retirement, at an age not earlier than 59 ½, with ten years of service, with age 65 being normal retirement age. For the years ended December 31, 2022, 2021, and 2020, the Bank charged to operations $138,231, $117,157, and $129,512, respectively, for matching contributions. The Plan is designed to provide liquidity for the participants. However, the plan includes a put option, whereby the Company must purchase the participant's shares of stock at current fair value, subject to certain restrictions if that liquidity is not available. At December 31, 2022 and 2021, participants of the KSOP held 150,442 shares of Company stock. The fair value of these shares at December 31, 2022 and 2021, was $3.9 million and $3.8 million, respectively.

Phantom Stock Plan

The Bank has an Executive Phantom Stock Appreciation Plan and a Director Phantom Stock Appreciation Plan (Director Plan and Executive Plan) that provide for the issuance of phantom stock awards to directors and an executive of the Bank. A committee authorized by the Bank's Board of Directors has authority to administer the Director Plan and Executive Plan subject to the approval of the Bank's Board of Directors. For each of the years ended December 31, 2022, 2021, and 2020, the Bank charged $70,798, $79,330, and $103,648, to operations for the phantom stock plan and awarded 2,755, 3,325, and 3,594 shares, respectively.

Executive Plans

The value of each phantom share award will be, at the date of the grant award, equal to a percentage of the executive's base salary divided by the appraised value of the common stock of Heritage Bancshares of January 1 of the award year, providing pre-established goals, as established by the Board of Directors, have been met. The executive shall vest in the account balance in equal annual increments.

Upon retirement, voluntary termination and involuntary termination without cause, the executive is subject to a one-year non-compete clause in consideration for phantom share awards.

Director Plan

The value of each phantom share award will be, at the date of the grant award, (a) 100 percent of the Annual Incentive Compensation Award divided by the appraised value of the Common Stock of Heritage Bancshares of January 1 of the award year, (b) amount of the Annual Income Compensation Award shall be equal to 25 percent of the annual director's fees, including the retainer paid to the director, providing pre-established goals, as established by the Board of Directors, have been met. The director is immediately vested in the plan. In the event of death, disability, or separation of service, the director will receive his or her net book value in a lump sum payment.

13. REGULATORY MATTERS

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically under-capitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. As of December 31, 2022, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

In November 2019, federal bank regulatory agencies finalized a rule that simplifies capital requirements for community banks by allowing them to optionally adopt a simple leverage ratio to measure capital adequacy, which removes requirements for calculating and reporting risk-based capital ratios for a qualifying community bank that has less than $10 billion in total consolidated assets, limited amounts of off-balance-sheet exposures and trading assets and liabilities, and a leverage ratio greater than 9 percent. The community bank leverage ratio framework was effective on January 1, 2020. The Bank has elected to adopt the optional community bank leverage ratio framework in the first quarter of 2020.

In April 2020, the federal banking regulatory agencies modified the original community bank leverage ratio (CBLR) framework and provided that, as of the second quarter 2020, a banking organization with a leverage ratio of 8 percent or greater and that meets the other existing qualifying criteria may elect to use the community bank leverage ratio framework. The modified rule also states that the community bank leverage ratio requirement will be greater than 8 percent for the second through fourth quarters of calendar year 2020, greater than 8.5 percent for calendar year 2021, and greater than 9 percent thereafter. The transition rule also maintains a two-quarter grace period for a qualifying community banking organization whose leverage ratio falls no more than 100 basis points below the applicable community bank leverage ratio requirement.

The leverage ratios of the Bank at December 31, 2022 and 2021, are as follows:

As of December 31, 2022	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
First Exchange Bank						
Tier 1 leverage	$ 32,100	9.91 %	$ 12,959	4.00 %	$ 16,199	5.00 %

As of December 31, 2021	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
First Exchange Bank						
Tier 1 leverage	$ 30,694	9.53 %	$ 12,878	4.00 %	$ 16,097	5.00 %

Heritage Bancshares, Inc. is a small bank holding company and is exempt from regulatory capital requirements administered by the federal banking agencies.

14. FAIR VALUE MEASUREMENTS

The following disclosures show the hierarchal disclosure framework associated with the level of pricing observations utilized in measuring assets and liabilities at fair value. The three broad levels of pricing observations are as follows:

Level I: Quoted prices are available in active markets for identical assets or liabilities as of the reported date.

Level II: Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.

Level III: Valuations are derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires the use of observable market data, when available.

The following tables present the assets reported on a recurring basis on the Consolidated Balance Sheet at their fair value as of December 31, 2022 and 2021, by level within the fair value hierarchy. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	December 31, 2022			
	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agencies and corporations	$ -	$ 1,637,975	$ -	$ 1,637,975
Mortgage-backed securities - U.S. government agencies and corporations	-	33,438,125	-	33,438,125
Total	$ -	$ 35,076,100	$ -	$ 35,076,100

	December 31, 2021			
	Level I	Level II	Level III	Total
Assets measured on a recurring basis:				
U.S. government agencies and corporations	$ -	$ 2,148,116	$ -	$ 2,148,116
Mortgage-backed securities - U.S. government agencies and corporations	-	33,235,026	-	33,235,026
Total	$ -	$ 35,383,142	$ -	$ 35,383,142

The following tables present the assets measured on a nonrecurring basis on the Consolidated Balance Sheet at December 31, 2022 and 2021, by level within the fair value hierarchy. Impaired loans that are collateral-dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secure the impaired loans include quoted market prices for identical assets classified as Level I inputs and observable inputs, employed by certified appraisers, for similar assets classified as Level II inputs. In cases where valuation techniques included inputs that are unobservable and are based on estimates and assumptions developed by management based on the best information available under each circumstance, the asset valuation is classified as Level III inputs.

14. FAIR VALUE MEASUREMENTS (Continued)

Certain assets, such as other real estate owned (OREO) acquired through foreclosure, are initially recorded at fair value of the property, at the transfer date less estimated selling costs. At or near the time of foreclosure, real estate appraisals are obtained on the properties acquired through foreclosure. The real estate is then valued and subsequently carried at the lesser of the appraised value or the loan balance, including interest receivable at the time of foreclosure, less an estimate of costs to sell the property. Appraised values are typically determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser outside of the Company, using observable market data or on a recent sales offer (Level II). However, if the acquired property is a house or building in the process of construction, or if an appraisal of the real estate property is over two years old, then the fair value is considered Level III. The estimate of costs to sell the property is based on historical transactions of similar holdings.

	December 31, 2022			
	Level I	Level II	Level III	Total
Assets measured on a nonrecurring basis:				
Impaired loans:				
Commercial real estate	$ -	$ -	$ -	$ -
Commercial	-	-	1,876,300	1,876,300
Other real estate owned	-	-	84,887	84,887
Total	$ -	$ -	$ 1,961,187	$ 1,961,187

	December 31, 2021			
	Level I	Level II	Level III	Total
Assets measured on a nonrecurring basis:				
Impaired loans:				
Commercial real estate	$ -	$ -	$ 416,775	$ 416,775
Commercial	-	-	2,862,125	2,862,125
Other real estate owned	-	-	84,887	84,887
Total	$ -	$ -	$ 3,363,787	$ 3,363,787

The following table presents additional qualitative information about assets measured on a nonrecurring basis and how the Company has utilized Level III inputs to determine fair value:

	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range
		2022		
Impaired loans:				
Commercial	1,876,300	Appraisal of collateral	Selling costs	6% discount
Other real estate owned	84,887	Appraisal of collateral	Management adjustments for liquidation expenses	20% - 85% discount
		2021		
Impaired loans:				
Commercial real estate	$ 416,775	Appraisal of collateral	Selling costs	9% discount
Commercial	2,862,125	Appraisal of collateral	Selling costs	6% discount
Other real estate owned	84,887	Appraisal of collateral	Management adjustments for liquidation expenses	20% - 85% discount

15. ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table presents the changes in accumulated other comprehensive income (loss), net of tax, for the years ended December 31, 2022, 2021, and 2020:

		Net Unrealized Gains (Losses) on Investment Securities (a)
Accumulated other comprehensive income, January 1, 2020	$	180,374
Unrealized holding losses on available-for-sale securities before reclassification		397,103
Accumulated other comprehensive income, December 31, 2020		577,477
Unrealized holding gains on available-for-sale securities before reclassification		(522,192)
Accumulated other comprehensive income, December 31, 2021		55,285
Unrealized holding losses on available-for-sale securities before reclassification		(5,886,290)
Accumulated other comprehensive loss, December 31, 2022	$	(5,831,005)

(a) Amounts in parenthesis indicate debits

There were no amounts reclassified from accumulated other comprehensive income during either period ended December 31.

16. CONDENSED FINANCIAL STATEMENTS

The investment of the Company in its wholly owned subsidiary is presented on the equity method of accounting. Information relative to the Company's Consolidated Balance Sheet at December 31, 2022 and 2021, and the related Consolidated Statements of Income and Cash Flows for the years ended December 31, 2022, 2021, and 2020, are presented below:

16. CONDENSED FINANCIAL STATEMENTS (Continued)

CONDENSED BALANCE SHEET

	2022	2021
ASSETS		
Cash	$ 121,215	$ 83,365
Investment in bank subsidiary, eliminated	26,268,858	30,749,646
TOTAL ASSETS	$ 26,390,073	$ 30,833,011
LIABILITIES AND SHAREHOLDERS' EQUITY		
Interest payable	$ 12,306	$ 4,752
Long-term borrowings	5,500,000	5,500,000
Other liabilities	631,902	559,425
TOTAL LIABILITIES	6,144,208	6,064,177
TOTAL SHAREHOLDERS' EQUITY	20,245,865	24,768,834
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 26,390,073	$ 30,833,011

CONDENSED STATEMENTS OF INCOME

	Year Ended December 31,		
	2022	2021	2020
Dividends from subsidiary bank	$ 2,125,000	$ 2,685,000	$ 2,599,000
Interest expense	(189,578)	(105,219)	(134,463)
Expenses - operating	(44,860)	(44,089)	(43,729)
Income before undistributed income	1,890,562	2,535,692	2,420,808
Equity in undistributed net income of subsidiary	1,405,502	519,786	960,058
NET INCOME	$ 3,296,064	$ 3,055,478	$ 3,380,866
COMPREHENSIVE (LOSS) INCOME	$ (2,590,226)	$ 2,533,286	$ 3,777,969

16. CONDENSED FINANCIAL STATEMENTS (Continued)

CONDENSED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2022	2021	2020
OPERATING ACTIVITIES			
Net income	$ 3,296,064	$ 3,055,478	$ 3,380,866
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net income of subsidiary	(1,405,502)	(519,786)	(960,058)
Increase (decrease) in other liabilities	7,554	229	(7,248)
Capital contribution to Bank	-	(1,153,000)	-
Net cash provided by operating activities	1,898,116	1,382,921	2,413,560
FINANCING ACTIVITIES			
Proceeds from sale of treasury stock	60,015	15,407	50,000
Purchase of common stock	(60,015)	(13,558)	(137,500)
Cash dividends paid	(1,860,266)	(2,391,769)	(1,984,140)
Net cash used for financing activities	(1,860,266)	(2,389,920)	(2,071,640)
Change in cash and cash equivalents	37,850	(1,006,999)	341,920
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	83,365	1,090,364	748,444
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 121,215	$ 83,365	$ 1,090,364
SUPPLEMENTAL DISCLOSURE OF CASH FLOW			
Dividends declared but unpaid	$ 591,901	$ 519,424	$ 857,655

16. CONDENSED FINANCIAL STATEMENTS (Continued)

Heritage Bancshares, Inc. accounts for its investments in its bank subsidiary by the equity method. During the years ended December 31, 2022, 2021, and 2020 changes were as follows:

Number of shares owned – First Exchange Bank	56,000
Percent of shares owned – First Exchange Bank	100 percent

Balance at December 31, 2019	$	28,241,891
Add:		
Equity in net income		960,058
Change in net unrealized gains on securities		397,103
		29,599,052
Balance at December 31, 2020		
Add (deduct):		
Equity in net income		519,786
Change in net unrealized gains on securities		(522,192)
Capital contribution from Heritage Bancshares, Inc.		1,153,000
Balance at December 31, 2021		30,749,646
Add (deduct):		
Equity in net income		1,405,502
Change in net unrealized loss on securities		(5,886,290)
Balance at December 31, 2022	$	26,268,858

DIRECTORS

Directors of Heritage Bancshares, Inc.

J. Adam Boyers .... Businessman - President, Middletown Tractor Sales
James A. Boyers .... Pharmacist - Consultant, Owner - Paradise Valley Farm,
Member - Boyers' Enterprises and Endeavors Unlimited,
Chairman – Heritage Bancshares, Inc.
William F. Goettel .... President/Chief Executive Officer, First Exchange Bank
R. William Kent... Executive Vice President, Capital Markets, CBRE, Inc. (Retired)
Mark A. Mangano .... President and CEO, West Virginia Bankers Association
Kevin Rogers .... President, Rogers Electric
Michael C. Seese .... Co-Founder and Financial Advisor, Commonwealth
Financial Services
William J. Yoho.. Associate Broker, Springston & Co., Inc.,
Real Estate Appraiser
Kevin Wilfong .... President - Middletown Properties, Real Estate Developer/
Property Management

Directors of First Exchange Bank

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Financial Services
William J. Yoho.. Associate Broker, Springston & Co., Inc.,
Real Estate Appraiser
Kevin Wilfong .... President - Middletown Properties, Real Estate Developer/
Property Management

Current Branch Locations

White Hall Office/Corporate Headquarters
1 Heritage Way
White Hall, WV 26554
Phone (304) 534-7200 Fax (304) 986-1125

Mannington Office
11 West Main Street, P.O. Box 388
Mannington, WV 26582
Phone (304) 986-1700 Fax (304) 986-1711

Fairmont Office
216 Fairmont Avenue
Fairmont, WV 26554
Phone (304) 367-1700 Fax (304) 367-1779

Hundred Office
Route 250, P.O. Box 780
Hundred, WV 26575
Phone (304) 775-1700 Fax (304) 775-1702

Fairview Office
309 Main Street
Fairview, WV 26570
Phone (304) 449-1700 Fax (304) 449-1967

Suncrest Office
3051 University Avenue
Morgantown, WV 26505
Phone (304) 225-2600 Fax (304) 225-2605

Pierpont Office
1000 Mid Atlantic Drive
Morgantown, WV 26508
Phone (304) 284-1700 Fax (304) 284-1706