

**Board of Governors of the Federal Reserve System
Washington, D.C. 20551**

Form 10-KSB

**ANNUAL REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

BANK OF MCKENNEY

(Name of small business issuer in its charter)

VIRGINIA (State or other jurisdiction of incorporation or organization)	54-0132540 (I.R.S. Employer Identification No.)
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20718 First Street, McKenney, Virginia 23872
(Address of principal executive offices) (Zip Code)

Issuer's telephone number: (804) 478-4434

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, \$2.00 par value
(Title of Class)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

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

Issuer's revenue for the fiscal year ended December 31, 2006: \$10,593,000.

The aggregate market value of Bank of McKenney voting stock held by non-affiliates as of March 12, 2007 was \$18,850,660. This figure is based on the closing price of \$10.65 per share of the Registrant's common stock on March 12, 2007.

The number of shares of common stock outstanding as of March 12, 2007 was 1,926,656.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be used in conjunction with the registrant's 2007 Annual Meeting of Shareholders are incorporated into Part III of this Form 10-KSB.

Transitional Small Business Disclosure Format: Yes No

PART I	<u>Page</u>
Item 1. Description of Business	1
Item 2. Description of Property.....	11
Item 3. Legal Proceedings.....	11
Item 4. Submission of Matters to a Vote of Security Holders	11
 PART II	
Item 5. Market for Common Equity and Related Stockholder Matters	12
Item 6. Management’s Discussion and Analysis or Plan of Operation.....	12
Item 7. Financial Statements	30
Item 8. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure.....	55
Item 8A. Controls and Procedures.	55
Item 8B. Other Information	55
 PART III	
Item 9. Directors, Executive Officers, Promoters, Control Persons and Corporate Governance; Compliance with Section 16(a) of the Exchange Act	55
Item 10. Executive Compensation	55
Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	55
Item 12. Certain Relationships and Related Transactions, and Director Independence	56
Item 13. Exhibits	56
Item 14. Principal Accountant Fees and Services.....	56
 SIGNATURES	

This Form 10-KSB contains, in addition to historical information, various “forward-looking statements” that represent the Bank’s judgment concerning the future. For this purpose any statements contained in this Form 10-KSB that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, words such as “may,” “will,” “expect,” “believe,” “anticipate,” “estimate” or “continue” or comparable terminology are intended to identify forward-looking statements. These statements by their nature involve substantial risks and uncertainties, and actual operating results and financial position may differ materially depending on a variety of factors about which the Bank is unable to predict. In this report, we frequently use the terms “we”, “our” and “us” to refer to Bank of McKenney and our Subsidiary.

PART I.

Item 1. Description of Business

General

Bank of McKenney (the “Bank”) is a Virginia chartered community bank that was established in 1906 and is headquartered in McKenney, Virginia. We provide customized banking solutions to small and medium sized businesses, professionals and individuals in Dinwiddie, Prince George and Chesterfield counties and the City of Colonial Heights. In addition, we attract customers from portions of Sussex, Nottoway, and Brunswick counties. We offer a full range of banking and related financial services, including checking, savings, certificates of deposit and other depository services, credit cards, commercial and residential real estate and consumer loan services, and safekeeping services.

Since our current management team was put in place in 1989, we have experienced significant growth. The Bank has grown from \$20 million in assets in 1989 to approximately \$152 million at December 31, 2006, and our shareholders’ equity has grown from approximately \$700,000 in 1989 to \$16.9 million at 2006 year’s end. Furthermore, we have paid an annual dividend for at least the last 41 years. The Bank is a publicly traded company with its securities listed on the Nasdaq Capital Market under the symbol “BOMK”.

The primary source of our revenue is interest income and fees generated by lending and investing funds on deposit. We typically balance the loan and investment portfolio towards loans. Loans generally earn more attractive returns than investments and are a key source of product cross sales and customer referrals. Certain economic conditions, such as poor regional corporate earnings, real estate cycles and other general slowing economic conditions may favor investments over loans. These conditions may lead to weaker fundamental performance. Our loan and investment strategies balance the need to maintain adequate liquidity through excess cash or federal funds sold with opportunities to appropriately leverage our capital.

As a community-oriented and locally-owned institution, we invest our loan resources in the community and tailor our services to meet the banking and financial needs of our customers who live and do business in the communities we serve. We strive to serve the banking needs of our customers by developing and maintaining long-term relationships, which will sustain the economic vitality of both the community and the Bank.

By hiring experienced professional community bankers to direct our activities, we offer the personalized, efficient service that differentiates a successful “community bank” from large bank holding companies. Also, with the flexibility of our smaller size and through an emphasis on personal attention and service, we can be more responsive to the individual needs of our customers than our larger competitors.

The Bank provides non-deposit investment services, insurance products and business management solutions services to customers through McKenney Group, LLC, a wholly owned subsidiary of the Bank, formed in July 2001. The Bank also derives some fees from appraisal services.

Strategy and Philosophy

The Bank's strategic plan is directed toward enhancing franchise value and operating profitability by increasing its asset size through quality products and services, further expanding our trade area and enhancing the use of the Internet in our operations. Our present capitalization will enable us to expand our branch network and allows us to meet the borrowing needs of most of our customers. When opportunities develop that exceed our legal lending limit, we act as a conduit to other sources for such funds. This is consistent with our philosophy of acting in our customers' best interests to build relationships. Our board of directors believes that superior service and credit underwriting enables us to obtain a reasonable market share within a highly competitive market.

Our core business philosophy involves providing superior customer service to clients, with local decision makers facilitating the transactions. Our experienced executives focus on relationships with each client and bring value to all phases of a client's business and personal banking needs. To develop this strategy, our focus has been to establish relationships with key customers in the community and centers of influence that can create business opportunities. This focus on relationship banking has led to our growth and profitability.

Employees

When the Bank opened in 1906, it had one employee. That number has grown to 61 full-time equivalent employees. None of our employees are represented by any collective bargaining unit, and we believe that relations with our employees are good.

Market Area

In addition to Dinwiddie County, Prince George County, Chesterfield County and the City of Colonial Heights, the Bank pulls customers from portions of Sussex, Nottoway, and Brunswick counties. The Bank's market area is supported primarily by trade, services and manufacturing. According to 2005 census data estimates, the population of Dinwiddie County was 25,391, a 3.5% increase from 2000. The median household income in Dinwiddie County in 2003 was \$42,066, representing an increase of 20.8% over 2000. The population of the City of Colonial Heights was estimated at 17,567 in 2005, a 4.0% increase in comparison to 2000. Median household income grew to \$43,754 in 2003, representing an increase of 6.9% over that reported in 2000. The population in Chesterfield had increased 11.2% from 259,903 in 2000 to a projected 288,876 in 2005, and the median household income had grown 11.7% to \$61,807 in 2003. Prince George County's estimated population as reported in the 2005 census data reached 36,725, a 10.9% increase from that in the 2000 report. Median household income in Prince George in 2003 was \$49,394, virtually unchanged from that reported in 2000.

We believe that these trends in the demographics, particularly the strong growth in southern Chesterfield County, will provide excellent opportunities for the Bank's continued expansion and long-term growth.

Lending Activities

The Bank's primary market focus is on making loans to small businesses and consumers in its local market area. In addition, we also provide a wide range of real estate finance services. Our primary lending activities are principally directed to the areas in and around our defined market region of Dinwiddie County, Prince George County, Chesterfield County and the City of Colonial Heights. The following detail the primary lending applications and general guidelines utilized by the Bank.

Personal Installment Loans – The Bank offers various types of secured and unsecured consumer loans, including lines of credit, for personal, family or household purposes. These loans can be structured in numerous ways, from a time note to an installment note to an open-end term as related to a line of credit. A consumer’s total debt service should not generally exceed 35%; however, there are instances that may warrant a higher ratio based upon other lending considerations. The underwriting standards for consumer loans include a determination of the applicant’s payment history with us, if applicable, and through the credit bureau. Verification of income is made when dealing with new borrowers or on existing customers who may have changed employment and/or source(s) of reported income since their last loan.

Commercial Real Estate Lending – Bank of McKenney primarily finances commercial real estate that is located within our market area. Our underwriting targets not only the valuation of the property but also the creditworthiness of the borrowers/guarantors and a cash flow analysis. By carefully underwriting commercial real estate loans and adhering to our loan-to-value margins of 80% or less when warranted, we are able to mitigate risk inherent with sudden or gradual drops in market values attributable to economic conditions.

Residential Real Estate Loans – Bank of McKenney offers permanent real estate loans along with equity loan products that are maintained within its portfolio. Additionally, the Bank has a “fixed rate” loan department that can offer various types of loan products that are originated under the Bank’s name but are closed in the name of the lender that will do the permanent financing. The Bank’s permanent financing is available in the form of a balloon loan with a rate lock of 3 to 5 years amortized up to 30 years. Home equity lines of credit have become a very popular source of financing in recent years. Typically, we consider up to 80% of the appraised value of an existing home, or the purchase price, whichever is less, and take from that any existing mortgage balance in order to ascertain the “lendable equity”. This product is targeted for the customer with excellent credit history. Second mortgages are available as well. Again, the Bank generally considers 80% loan-to-value (“LTV”), based upon appraised/market value and balance of the existing mortgage. The maximum amortization is 20 years with 3 to 5 year rate locks. There are times when exceptions to the 80% LTV policy are warranted and justifiable. In those cases, the exception to go as high as 90% LTV must be approved through the Credit Committee.

Real Estate Construction Lending – This portion of our loan portfolio is primarily residential and is comprised of loans with short durations. The usual maturity on a loan of this nature is 12 months or less. Interest is typically paid monthly on the outstanding balance until it is converted to a permanent mortgage. The Bank will advance up to 80% of the appraised value of the completed project based upon plans and specifications. Our policy is to have a draw schedule established and after inspections and title policy updates and mechanics lien waivers, the advance is made, based upon the percentage of work completed. A critical part of construction lending is to ensure that the borrower has arranged a “take-out” via a permanent mortgage upon completion. We are fortunate in that we can provide the permanent financing, if the borrower so chooses, either “in-house” or through our Fixed Rate Mortgage Department as described earlier.

Credit Policies – The Bank utilizes a comprehensive written loan policy and related procedures to enhance management of credit risk. The loan policy is reviewed at least annually by the board of directors and may change if there are significant changes in

- the local or national economy;
- money market conditions;
- the Bank’s financial condition or loan portfolio mix;
- competitive conditions; or
- noted unstableness in any industry.

The purpose of the detailed loan policy is to establish guidelines for lending which are broad enough to allow the loan officer to function properly within certain known parameters. Its intent is also to be specific enough to make it clear that certain loan situations are to be avoided while others are to be encouraged. Moreover, its purpose is to establish loan procedures, outline basic credit criteria, and specify desirable and undesirable loan categories. The policy does not discriminate against any person because of race, color, creed, sex or age.

As a general philosophy, it is important to the Bank that loan officers do not accept loans where there is poor cash flow and the collateral value is not sufficient enough to secure the loan. The Bank's loan objectives and lending conditions are consistent with the following:

- deposit growth – attracting new customers;
- preserving present deposits – honoring old Bank relationships;
- maximizing profitability of the Bank's earning assets;
- safety of principal;
- serving the credit needs of the Bank's primary service area;
- the Bank's liquidity;
- the loan portfolio mix; and
- loans that stimulate economic growth in the primary service area are preferred over personal investment type loans.

The loan making process includes formulation of portfolio management strategy, guidelines for underwriting standards and risk assessment, procedures for ongoing identification and management of credit deterioration, and regular portfolio reviews to estimate loss exposure and ascertain compliance with the Bank's policies. Lending authority is granted to individual lending officers, with the current highest limit being \$150,000 for either secured or unsecured loans. An Officer's Loan Committee comprised of all officers of the Bank and requiring positive action by three or more members can approve credits of up to \$500,000. The Director's Loan Committee, consisting of the entire board of directors, meeting monthly, can approve loans over \$500,000, requiring at least three members to be present in order to act. The Bank's legal lending limit for loans to one borrower was \$2,538,000 as of December 31, 2006.

A major element of credit risk management is diversification and avoidance of concentrations of credit. The Bank's objective is to maintain a diverse loan portfolio to minimize the impact of any single event or set of circumstances. Concentration of credit is defined as being any loan or group of loans that exceed 25% of the Bank's capital that are to one individual, a related group of borrowers or one particular industry. The Bank also maintains strict guidelines relative to managing risk related to concentrations of credit, including:

- enhanced credit criteria;
- additional controls to minimize exposure;
- strict caps on the size of concentration; and
- increased capital and loan loss reserves to cover any increased exposure.

The Bank also purchases participations in loans from other banks from time to time, as well as sells participations to other banks to participate in loans originated by Bank of McKenney, in order to manage liquidity and to diversify its loan portfolio and effectively manage risk.

Investments and Funding

The Bank balances the liquidity needs of the organization based on loan and deposit growth via the investment portfolio and purchased funds. It is our goal to provide adequate liquidity to support the loan growth of the organization. In the event the Bank has excess liquidity, investments are used to generate positive earnings. In the event deposit growth does not fully support the organization's loan growth, a combination of investment sales, federal funds and other established borrowing avenues will be used to augment the Bank's funding position.

The investment portfolio is actively managed and is generally classified as "Available For Sale." Under such a classification, investment instruments may be sold as deemed appropriate by management. On a monthly basis, the investment portfolio is marked to market via equity as required by Financial Accounting Standards Board Statement of Financial Accounting Standard No. 115 ("SFAS No. 115"). Additionally, the investment portfolio is used to balance the asset and liability position of the Bank. We do invest in fixed rate or floating rate instruments as necessary to reduce our interest rate risk exposure.

Deposit Activities

Deposits are the major source of funding for the Bank. We offer a broad array of deposit products that include demand, NOW, certificates of deposit, money market and savings accounts. We typically pay a competitive rate on the interest bearing deposits; however, we may become slightly more or less competitive in our interest rate structure as our liquidity position changes. As a relationship-oriented organization, we seek generally to obtain deposit relationships with our loan clients.

Competition

We operate in highly competitive environments in our market areas, competing for deposits and loans with major regional and national banks, as well as other financial institutions, many of which have greater financial resources than we do. Most maintain numerous banking locations and many perform services, such as trust services, that we do not offer. Additionally, many of these competitors have higher lending limits than we do. We have been able to compete effectively with other financial institutions by:

- emphasizing personal relationship banking;
- establishing long-term customer relationships;
- building customer loyalty;
- providing products and services designed to address the specific needs of our customers; and
- promoting local management and decision making in our marketing strategies.

Parts of our primary service market are highly competitive and heavily branched. Competition for loans to small and medium-sized businesses, individuals and professionals, is intense, and pricing is important. Most of our competitors have substantially greater resources and lending limits than we do and offer services, such as extensive and established branch networks and trust services that we do not expect to provide in the near future. Moreover, larger institutions operating in our primary service area have access to borrowed funds at a lower rate than is available to us. Deposit competition is strong among institutions in our primary service area. As a result, it is possible that we may, to remain competitive, pay above-market rates for deposits. Despite strong competition, we are experiencing success in our primary service area because of the region's growth rate and the area reacting favorably to our community focus and our emphasis on service to the small and medium-sized business community, individuals and professionals.

Recent mergers of other area banks into large regional and national financial institutions have created opportunities for community focused and prudently managed community banks. While our board is aware of the competition that these larger institutions offer, we believe that local independent banks play a significant factor in our primary market area. Our board of directors believes it is a significant and distinct advantage to be a community owned and operated state bank interested exclusively in small and medium-sized businesses, professionals, and the citizens of Dinwiddie County, Prince George County, Chesterfield County, the City of Colonial Heights and adjacent areas.

Supervision and Regulation

General

We are organized as a Virginia-chartered banking corporation and are regulated and supervised by the Virginia Bureau of Financial Institutions. In addition, we are regulated and supervised by the Board of Governors of the Federal Reserve System (the "Federal Reserve"), which serves as our primary federal regulator. The Virginia Bureau of Financial Institutions and the Federal Reserve conduct regular examinations of the Bank, reviewing the adequacy of our loan loss reserves, the quality of our loans and investments, the propriety of management practices, compliance with laws and regulations, and other aspects of our operations.

Federal and Virginia banking laws and regulations govern all areas of our operations, including reserves, loans, mortgages, capital, issuance of securities, payment of dividends and establishment of branches. Federal and state bank regulatory agencies also have the general authority to limit the dividends paid by Federal Deposit Insurance Corporation-insured banks. The Federal Reserve and the Federal Deposit Insurance Corporation (the "FDIC") have authority to impose penalties, initiate civil and administrative actions and take other steps intended to prevent the Bank from engaging in unsafe or unsound practices. In this regard, the Federal Reserve and the FDIC have adopted capital adequacy requirements, which apply to us.

FDIC Deposit Insurance

The FDIC insures the deposits of the Bank up to the limits set forth under applicable law. On February 15, 2006, federal legislation to reform federal deposit insurance was enacted. The new law merged the old Bank Insurance Fund and Savings Association Insurance Fund into the single Deposit Insurance Fund (the "DIF"), increased deposit insurance coverage for IRAs to \$250,000, provides for the further increase of deposit insurance on all accounts by indexing the coverage to the rate of inflation, authorizes the FDIC to set the reserve ratio of the DIF at a level between 1.15% and 1.50%, and permits the FDIC to establish assessments to be paid by insured banks to maintain the minimum ratios.

On November 2, 2006, the FDIC adopted final regulations establishing a risk-based assessment system that is intended to more closely tie each bank's deposit insurance assessments to the risk it poses to the DIF. Under the new risk-based assessment system, which became effective in the beginning of 2007, the FDIC will evaluate each bank's risk based on three primary factors: (1) its supervisory rating, (2) its financial ratios, and (3) its long-term debt issuer rating, if the bank has one.

The new assessment rates for most banks will vary between five and seven cents for every \$100 of domestic deposits. Applied to the Bank's assessment base of approximately \$115 million, this translates to an annual deposit premium estimated to be between \$57,500 and \$80,500. Most banks, including Bank of McKenney, have not been required to pay any deposit insurance premiums since 1995.

As part of the reform, Congress provided credits to institutions that paid high premiums in the past to bolster the FDIC's insurance reserves. As a result, according to the FDIC, the majority of banks will have assessment credits to initially offset all of their premiums in 2007. The preliminary assessment credit for the Bank was calculated at \$51,393. The assessment credit will not be recognized up front, but recognized on a go-forward basis only to the extent the credit is used to reduce future deposit premiums that would otherwise be due. Accordingly, we expect the reinstatement of deposit premiums by the FDIC will not have a material effect on our financial condition, results of operations or cash flows in 2007.

Capital Requirements

The federal bank regulatory agencies have adopted risk-based capital requirements for assessing bank capital adequacy. Virginia chartered banks must also satisfy the capital requirements adopted by the Virginia Bureau of Financial Institutions. The federal capital standards define capital and establish minimum capital requirements in relation to assets and off-balance sheet exposure, as adjusted for credit risk. The risk-based capital standards currently in effect are designed to make regulatory capital requirements more sensitive to differences in risk profile among bank holding companies and banks, to account for off-balance sheet exposure and to minimize disincentives for holding liquid assets. Assets and off-balance sheet items are assigned to broad risk categories, each with appropriate risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance sheet items.

The minimum standard for the ratio of capital to risk-weighted assets (including certain off-balance sheet obligations, such as stand-by letters of credit) is 8.00%. At least half of the risk-based capital must consist of common equity, retained earnings and qualifying perpetual preferred stock, less deductions for goodwill and various other tangibles ("Tier 1 capital"). The remainder ("Tier 2 capital") may consist of a limited amount of subordinated debt, certain hybrid capital instruments and other debt securities, preferred stock and a limited amount of the general valuation allowance for loan losses. The sum of Tier 1 capital and Tier 2 capital is "total risk-based capital." The Federal Reserve has also adopted regulations that supplement the risk-based guidelines to include a minimum leverage ratio of Tier 1 capital to quarterly average assets of 4.00%. At December 31, 2006, we had the following risk-based capital and leverage ratios relative to regulatory minimums:

<u>Ratio</u>	<u>Bank of McKenney</u>	<u>Minimum</u>
Tier 1 risk-based capital	15.35%	4.00%
Total risk-based capital	16.18%	8.00%
Leverage	11.45%	6.00%

The Federal Reserve is authorized by federal legislation and regulations to take various enforcement actions against any undercapitalized insured depository institution and any insured depository institution that fails to submit an acceptable capital restoration plan or fails to implement a plan accepted by the FDIC. These powers include, among other things, requiring a bank to be recapitalized, prohibiting asset growth, restricting interest rates paid, requiring prior approval of capital distributions, requiring divestiture by the institution of its subsidiaries, requiring new election of directors, and requiring the dismissal of directors and officers.

Dividends

The amount of dividends payable by us depends upon our earnings and capital position and is limited by the federal and state law, regulations and policy. In addition, Virginia law imposes restrictions on the ability of all banks chartered under Virginia law to pay dividends. No dividend may be declared or paid that would impair a bank's paid-in capital. The Virginia Bureau of Financial Institutions and the FDIC have the general authority to limit dividends paid by the Bank if such payments are deemed to constitute an unsafe and unsound practice. In particular, Section 38 of the Federal Deposit Insurance Act would prohibit the Bank from making a dividend if it were "undercapitalized" or if such dividend would result in the institution becoming "undercapitalized."

Community Reinvestment Act

Banks are subject to the provisions of the Community Reinvestment Act of 1977 (the "CRA") that requires the appropriate federal bank regulatory agency, the Federal Reserve in our case, to assess our record in meeting the credit needs of the communities we serve. The Federal Reserve's assessment of our record is publicly available. The CRA assessment is required by any bank that has applied to, among other things, establish a new branch office that will accept deposits, relocate an existing office, or merge, consolidate with or acquire the assets or assume the liabilities of a federally regulated financial institution. We received an "Outstanding" rating in our last CRA exam in July 2002.

Gramm-Leach-Bliley Act

The Gramm-Leach-Bliley Act of 1999 implemented major changes to the statutory framework for providing banking and other financial services in the United States. The act, among other things, eliminated many of the restrictions on affiliations among banks and securities firms, insurance firms, and other financial service providers. A bank holding company qualifying as a financial holding company will be permitted to engage in activities that are financial in nature or incidental or complimentary to a financial activity. The activities that the act expressly lists as financial in nature include insurance activities, providing financial and instant advisory services, underwriting services and limited merchant banking activities. To become eligible for these expanded activities, a bank holding company must qualify as a financial holding company. We presently have no plans to form a bank holding company or to become a financial holding company.

The act also provided new protections against the transfer and use by financial institutions of consumers' nonpublic personal information. A financial institution must provide to its customers, at the beginning of the customer relationship and annually thereafter, the institution's policies and procedures regarding the handling of customers' nonpublic personal financial information. The privacy provisions generally prohibit a financial institution from providing a customer's personal financial information to unaffiliated third parties unless the institution discloses to the customer that the data may be so provided and the customer is given the opportunity to opt out of such disclosure.

Although considered to be one of the most significant banking laws since Depression-era statutes were enacted, because of our relatively recent organization, we do not expect the Gramm-Leach-Bliley Act to materially affect our products, services or other business activities. To the extent that it allows banks, securities firms, and insurance firms to affiliate, the financial services industry may experience further consolidation. The act may have the result of increasing the amount of competition that we face from larger institutions and other companies offering financial products and services, many of which may have substantially more financial resources.

USA Patriot Act of 2001

In October, 2001, the USA Patriot Act of 2001 (the “Patriot Act”) was enacted in response to the terrorist attacks in New York, Pennsylvania and Northern Virginia which occurred on September 11, 2001. The Patriot Act is intended to strengthen U.S. law enforcements’ and the intelligence communities’ abilities to work cohesively to combat terrorism on a variety of fronts. The continuing and potential impact of the Patriot Act and related regulations and policies on financial institutions of all kinds is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws, and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

Check 21

On October 28, 2003, President Bush signed into law the Check Clearing for the 21st Century Act, also known as Check 21. Check 21 gives “substitute checks,” such as a digital image of a check and copies made from that image, the same legal standing as the original paper check. Some of the major provisions of Check 21 include:

- allowing check truncation without making it mandatory;
- demanding that every financial institution communicate to accountholders in writing a description of its substitute check processing program and their rights under the law;
- legalizing substitutions for and replacements of paper checks without agreement from consumers;
- retaining in place the previously mandated electronic collection and return of checks between financial institutions only when individual agreements are in place;
- requiring that when accountholders request verification, financial institutions produce the original check (or a copy that accurately represents the original) and demonstrate that the account debit was accurate and valid; and
- requiring re-crediting of funds to an individual’s account on the next business day after a consumer proves that the financial institution has erred.

This legislation likely will affect bank capital spending as many financial institutions assess whether technological or operational changes are necessary to stay competitive and take advantage of the new opportunities presented by Check 21.

Effect of Governmental Monetary Policies

Our operations will be affected not only by general economic conditions but also by the policies of various regulatory authorities. In particular, the Federal Reserve regulates money, credit conditions and interest rates in order to influence general economic conditions. These policies have a significant influence on overall growth and distribution of bank loans, investments and deposits, and affect interest rates charged on loans or paid for time and savings deposits. Federal Reserve monetary policies have had a significant effect on the operating results of commercial banks in the past and are expected to do so in the future.

Reporting Obligations under Securities Laws

The Bank is subject to the periodic reporting requirements of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as adopted by the Federal Reserve, including the filing of annual, quarterly and other reports with the Federal Reserve. As an Exchange Act reporting bank, the Bank is directly affected by the Sarbanes-Oxley Act of 2002 and regulations promulgated therein, which are aimed at improving corporate governance and reporting procedures. The Bank is complying with the new rules and regulations implemented pursuant to the Sarbanes-Oxley Act and intends to comply with any applicable rules and regulations implemented in the future.

Other Regulations

Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. The Bank’s loan operations will also be subject to federal laws applicable to credit transactions, such as:

- the federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- the Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- the Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- the Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies;
- the Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and
- the rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

In addition, the deposit operations of the Bank will be subject to:

- the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and
- the Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve Board to implement that Act, which govern automatic deposits to and withdrawals from deposit accounts and clients’ rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Item 2. Description of Property

The Bank's Headquarters office is located at 20718 First Street in McKenney, Virginia. The Bank, at present, has seven branch locations throughout south central Virginia:

- the Airport Branch, located in the northern end of Dinwiddie County;
- the Dinwiddie Branch located in central Dinwiddie County;
- the Matoaca Branch, located in southern Chesterfield County;
- the Ettrick Branch, located in southern Chesterfield near the cities of Colonial Heights and Petersburg;
- the McKenney Branch, located in southern Dinwiddie County in the Town of McKenney;
- the Colonial Heights Branch, located in the city of Colonial Heights; and
- the Prince George Branch temporarily located in central Prince George County.

All of our permanent facilities and branch locations are owned; however, the Bank is currently leasing the space for the temporary Prince George office. In February 2006, the Bank acquired for expansion of its trade area 1.5 acres on Jefferson Park Road in western Prince George near the County's border with the City of Hopewell. Design plans for this site have been approved and construction of the permanent branch is slated to begin during the first quarter. Completion of this project is expected by year's end. The Bank also owns four pieces of marketable property acquired in the ordinary course of our business.

We believe that the natural evolution of a community bank like Bank of McKenney is to expand delivery of our core products and services through our branch network. Accordingly, in the future we may take advantage of strategic opportunities presented to us by pursuing key market locations for new branches in our market area affected by recent bank mergers, struggling bank start-ups, or in those regions which tend to be overlooked by our larger competitors.

Item 3. Legal Proceedings

In the ordinary course of its operations, the Bank is a party to various legal proceedings. Based upon information currently available, management believes that such legal proceedings, in the aggregate, will not have a material adverse effect on the business, financial condition, or results of operations of the Bank.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted during the fourth quarter of the fiscal year covered by this report to a vote of security holders of the Bank through a solicitation of proxies or otherwise.

PART II.

Item 5. Market for Common Equity and Related Stockholder Matters

The Bank's common stock trades on the Nasdaq under the symbol "BOMK". There were 1,926,656 shares of the Bank's stock issued and outstanding at the close of business on December 31, 2006, which were held by approximately 442 shareholders of record. The closing price of the Bank's stock on December 31, 2006 was \$11.59 per share as compared to \$10.48 on December 31, 2005.

The following table summarizes the high and low sales prices and dividends declared for the two years ended December 31, 2006.

	Market Values				Dividends Declared	
	2006		2005		2006	2005
	High	Low	High	Low		
First Quarter	\$11.56	\$10.00	\$10.75	\$ 9.80	\$ -	\$ -
Second Quarter	12.60	10.35	10.40	9.80	-	-
Third Quarter	12.50	10.77	11.00	9.90	-	-
Fourth Quarter	12.40	10.50	10.55	9.75	0.25	0.22

Item 6. Management's Discussion and Analysis or Plan of Operation

The summary financial data should be read in conjunction with the historical financial statements and the notes thereto included elsewhere in this document.

Critical Accounting Policies

The Bank's financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset or relieving a liability. We use historical loss factors as one factor in determining the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from the historical factors that we use. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependant.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual customer and residential loans for impairment disclosures.

In preparing consolidated financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses.

Period Ended December 31,

	2006	2005	2004	2003	2002
--	------	------	------	------	------

(Dollars in Thousands, except per share and share information)

Income Statement Data:

Interest income	\$ 9,123	\$ 7,882	\$ 7,085	\$ 6,606	\$ 6,504
Interest expense	3,334	2,294	1,742	1,618	2,112
Net interest income	5,789	5,588	5,343	4,988	4,392
Provision for loan losses	46	41	102	126	172
Non-interest income	1,470	1,429	1,429	1,568	1,359
Non-interest expense	5,375	5,047	4,844	4,497	3,938
Income taxes	571	606	577	633	525
Net income	\$ 1,267	\$ 1,323	\$ 1,249	\$ 1,300	\$ 1,116

Per Share and Shares Outstanding Data:

Basic net income	\$ 0.66	\$ 0.69	\$ 0.65	\$ 0.67	\$ 0.74
Fully diluted net income	0.66	0.69	0.65	0.67	0.74
Cash dividends declared	0.25	0.22	0.20	0.17	0.15
Book value at period end	8.78	8.19	7.97	7.56	7.14
Shares outstanding, period end	1,926,656	1,926,656	1,926,656	1,926,656	1,926,656
Average shares outstanding, basic	1,926,656	1,926,656	1,926,656	1,926,656	1,504,464
Average shares outstanding, diluted	1,926,656	1,926,656	1,926,656	1,926,656	1,504,464

Balance Sheet Data:

Total assets	\$ 151,879	\$ 142,202	\$ 132,271	\$ 124,317	\$ 105,262
Total loans, net	100,902	93,294	92,708	85,304	72,345
Total investment securities	29,191	26,303	21,240	18,123	12,873
Total interest-bearing time deposits in other banks	--	3,015	--	--	200
Total deposits	119,262	110,663	111,070	103,757	90,366
Total borrowed funds	14,000	14,348	4,702	5,057	276
Shareholders' equity	16,918	15,782	15,364	14,560	13,747

Performance Ratios:

Return on average assets	0.86%	0.95%	0.97%	1.16%	1.19%
Return on average equity	7.64%	8.35%	8.24%	9.04%	11.47%
Net interest margin ⁽¹⁾	4.38%	4.54%	4.69%	5.02%	5.31%

Asset Quality Ratios: ⁽²⁾

Allowance to period-end loans	1.05%	1.09%	1.07%	1.04%	1.09%
Non-performing assets to total loans	1.53%	1.86%	1.71%	0.08%	0.10%

Capital Ratios:

Tier I risk-based capital	15.35%	15.99%	15.35%	16.01%	17.96%
Total risk-based capital	16.18%	16.79%	16.14%	16.79%	18.77%
Leverage capital ratio	11.45%	11.33%	11.70%	12.41%	13.14%

⁽¹⁾ Net interest income divided by total average earning assets.

⁽²⁾ Non performing assets consist of nonaccrual loans, restructured loans and foreclosed properties.

Overview

For the year ended December 31, 2006, net income amounted to \$1,267,000 compared to net income of \$1,323,000 for the same period in the prior year. Basic and diluted earnings per share, as adjusted for the common stock dividend, were \$0.66 for the year ended December 31, 2006 compared to the prior year earnings per share of \$0.69 per common share. Weighted average shares outstanding for both periods equaled 1,926,656. The 4.23% decrease in earnings is primarily attributable to the start-up costs associated with the new Prince George temporary location as well as additional advertising and promotional efforts associated with the centennial anniversary of the Bank's 1906 opening. A rising rate environment resulting from the Federal Reserve's increases to the short-term funds rates added further pressure to net income as higher deposit rates were mandated in order to remain competitive in local markets. However, higher revenues generated through our financial services subsidiary and secondary market mortgage department along with an improving earning asset yield served to offset some of the aforementioned downward pressures. Return on average equity for the period ended December 31, 2006 was 7.64% compared to 8.35% in 2005. Return on average assets for the period ended December 31, 2006 was 0.86% compared to 0.95% in 2005.

Total assets amounted to \$151.9 million on December 31, 2006, an increase of 6.82% or \$9.7 million over the December 31, 2005 level of \$142.2 million. Total loans, as of December 31, 2006, grew to \$102.0 million compared to \$94.3 million as of December 31, 2005. The loan portfolio was up \$7.7 million or 8.17% over the December 31, 2005 level. At year-end 2006, the investment portfolio stood at \$29.2 million, which represents a 11.03% increase over the \$26.3 million prior year-end balance. Overnight federal funds sold increased \$1.1 million, or 26.19%, from \$4.2 million on December 31, 2005 to \$5.3 million on December 31, 2006. Cumulatively, these earning assets grew \$11.7 million or 9.38% during 2006 and represent 89.86% of total assets.

The allowance for loan losses was \$1,070,000 as of December 31, 2006 or 1.05% of loans outstanding, compared to \$1,025,000 as of December 31, 2005 or 1.09% of outstanding loans. The Bank works diligently to maintain quality in its loan portfolio and has historically maintained a delinquency ratio below 1%.

Total deposits amounted to \$119.3 million as of December 31, 2006, which represents an \$8.6 million or 7.77% increase from the \$110.7 million level as of December 31, 2005. Total noninterest-bearing demand deposits were \$23.9 million as of December 31, 2006, an increase of \$1.0 million or 4.37% over the December 31, 2005 level. During this same period, interest-bearing deposits climbed \$7.6 million or 8.66% from \$87.8 million to \$95.4 million.

Total borrowings from the Federal Home Loan Bank of Atlanta (the "FHLB") decreased \$0.3 million from \$14.3 million on December 31, 2005 to \$14.0 million as of December 30, 2006. The Bank did no additional borrowing through the FHLB during 2006 and is pleased thus far with the borrowing initiatives undertaken in 2005 designed to capitalize on the flattening yield curve of that period.

Total shareholders' equity was \$16.9 million as of December 31, 2006 and \$15.8 million as of December 31, 2005. The Bank's common stock trades on the Nasdaq Capital Market under the symbol "BOMK".

The Bank's net interest margin was 4.38% for the year ended December 31, 2006 as compared to 4.54% for same period on 2005. The Federal Reserve continued its tightening bias through their June 30, 2006 Federal Open Market Committee ("FOMC") meeting with a ¼% increase in the overnight lending rate to 5.25%. The Bank had positioned itself in shorter maturities and variable rate mechanisms in recent years to be properly positioned when rates were higher. Short-term earnings pressures did result as growth of average deposit costs outpaced average earning asset yields. Nevertheless, management believes its strategy prudent, and that the 16 basis point short-term margin sacrifice will be rewarded in future years.

The Bank is not aware of any current recommendations by any regulatory authorities, which, if they were implemented, would have a material effect on the Bank's liquidity, capital resources or results of operations.

Results of Operations

Net Interest Income. The net interest income for the year ended December 31, 2006 was \$5.8 million compared to \$5.6 million for the same period in 2005. This represents an increase of 3.57% over the net interest income earned during the 2005 fiscal year. The average loan portfolio increased \$6.2 million to \$100.4 million for the current fiscal year representing a 6.58% hike over the average loan portfolio assets of \$94.2 million for the same period in 2005. Average investments also climbed \$6.1 million to \$27.7 million for the current fiscal year representing a 28.24% rise over the prior year's average investment portfolio of \$21.6 million. Average demand deposits increased during 2006 to \$22.8 million as compared to \$22.3 million for the same period in 2005. Average interest-bearing deposits were \$93.0 million through December 2006 and represented an increase of \$3.7 million or 4.14% over the average December 2005 level of \$89.3 million. Finally, average borrowed funds increased \$3.8 million from the December 31, 2005 level of \$10.4 million to the December 31, 2006 level of \$14.2 million.

Interest expense for all interest bearing liabilities amounted to \$3.3 million in 2006, which was 43.48% or \$1.0 million greater than the 2005 level of \$2.3 million. Cost of interest bearing liabilities was 3.11% during 2006 or 81 basis points higher than the 2005 level of 2.30%. This increase is attributable to the higher average deposit rates as a result of recent trends in local markets precipitated by prevailing FOMC monetary policy.

Both the Bank's prime based loan portfolio and shorter positioned investment portfolio continue to see positive improvements from the interest rate increases experienced during the last two years. Yields on earning assets increased 50 basis points to 6.90% during 2006 from the 2005 level of 6.40%. While not as significant as liability cost acceleration during 2006, the bulk of the higher costs on deposits are now priced in while the asset re-pricing cycle will continue through the next twelve to eighteen months. With the rate environment more stable, the interest margin is now expected to follow a strengthening pattern.

The table on the following page compares the average balances of key asset and liability categories from 2006 to the year 2005. Average loan balances were \$100.4 million in 2006 as compared to \$94.2 million in 2005. The related interest income from loans was \$7.8 million in 2006 compared to \$6.8 million in 2005. The average yield on loans increased from 7.26% in 2005 to 7.73% in 2006. The investment securities and other earning assets (such as federal funds sold) contributed \$1.3 million to the interest income level of \$9.1 million in 2006. The yield on earning assets was 6.90% in 2006 and 6.40% in 2005. Consistent with asset growth the average interest bearing funding sources (deposit and purchased funds) grew to \$107.3 million in 2006, which was \$7.6 million, or 7.62% greater than the 2005 level of \$99.7 million.

The interest spread again narrowed for the twelve months of 2006 by 31 basis points to 3.79%. Accordingly, the net interest margin decreased for the twelve months of 2006 to 4.38% from 4.54% for the same period in 2005. The decrease in the net interest margin is primarily credited to the increased costs of funds from greater deposit rates demanded by local markets. This coupled with the expanded borrowing relationship with the FHLB during 2005 created short-term downward movement in both spreads and margins. With the liability re-pricing cycle virtually now complete, strengthening is forecasted to emerge as the pattern as the asset re-pricing cycle continues during the next two years.

The following table illustrates average balances of total interest earning assets and total interest bearing liabilities for the periods indicated, showing the average distribution of assets, liabilities, shareholders' equity and related income, expense and corresponding weighted average yields and rates. The average balances used in these tables and other statistical data were calculated using daily average balances.

Average Balances, Interest Income and Expense and Average Yields and Rates

	Period Ended December 31,					
	2006			2005		
	Average Balance	Income / Expense	Yield / ⁽⁴⁾ Rate	Average Balance	Income / Expense	Yield / ⁽⁴⁾ Rate
	(Dollars in Thousands)					
Assets:						
Interest earning assets:						
Investment securities ⁽¹⁾	\$ 27,689	\$ 1,173	4.24%	\$ 21,615	\$ 783	3.62%
Loans	100,373	7,756	7.73%	94,174	6,841	7.26%
Interest bearing balances with banks	1,262	59	4.68%	1,042	40	3.84%
Federal funds sold	3,158	153	4.84%	6,547	228	3.48%
Total interest earning assets	<u>132,482</u>	<u>9,141</u>	<u>6.90%</u>	<u>123,378</u>	<u>7,892</u>	<u>6.40%</u>
Non-interest earning assets:						
Cash and due from banks	4,176			5,152		
Premises and equipment	6,831			6,534		
Other assets	5,379			4,827		
Less: Allowance for loan losses	(1,052)			(1,020)		
	<u>15,334</u>			<u>15,493</u>		
	<u>\$ 147,816</u>			<u>\$ 138,871</u>		
Liabilities and Stockholders' Equity						
Interest bearing liabilities:						
Interest-bearing demand deposits	\$ 10,462	\$ 38	0.36%	\$ 11,182	\$ 40	0.36%
Money market deposit accounts	7,625	129	1.69%	8,308	84	1.01%
Savings accounts	13,120	79	0.60%	13,748	82	0.60%
Time deposits	61,832	2,416	3.91%	56,074	1,593	2.84%
Total interest-bearing deposits	<u>93,039</u>	<u>2,662</u>	<u>2.86%</u>	<u>89,312</u>	<u>1,799</u>	<u>2.01%</u>
Securities sold under repurchase agreements	34	2	5.88%	-	-	0.00%
FHLB Advances	14,175	670	4.73%	10,399	493	4.74%
Other borrowings	4	-	0.00%	25	2	8.00%
Total interest-bearing liabilities	<u>107,252</u>	<u>3,334</u>	<u>3.11%</u>	<u>99,736</u>	<u>2,294</u>	<u>2.30%</u>
Non-interest bearing liabilities:						
Demand deposits	22,787			22,298		
Other liabilities	1,201			984		
Total liabilities	<u>131,240</u>			<u>123,018</u>		
Shareholders' Equity	16,576			15,853		
Total Liabilities & Shareholders' Equity	<u>\$ 147,816</u>			<u>\$ 138,871</u>		
Interest Spread ⁽²⁾						
			3.79%			4.10%
Net Interest Margin ⁽³⁾						
		<u>\$ 5,807</u>	4.38%		<u>\$ 5,598</u>	4.54%

(1) Income and yields are reported on tax equivalent basis assuming a federal tax rate of 34%.

(2) Interest Spread is the average yield earned on earning assets, less the average rate incurred on interest bearing liabilities.

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

(4) Yields and rates are annualized.

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

Net Interest Income Volume and Rate Analysis

	Years Ended December 31, 2006 Compared to 2005		
	Change Due To:		
	(Dollars in Thousands)		
	Increase/ (Decrease)	Volume	Rate
Interest Earning Assets:			
Investments	\$ 390	\$ 242	\$ 148
Loans	915	461	454
Interest bearing balances with banks	19	9	10
Federal funds sold	(75)	(306)	231
Total Increase (Decrease) in Interest Income	1,249	406	843
Interest Bearing Liabilities:			
Interest bearing deposits	863	87	776
Borrowed funds	177	179	(2)
Total Increase (Decrease) in Interest Expense	1,040	266	774
Increase (Decrease) in Net Interest Income	\$ 209	\$ 140	\$ 69

Interest Rate Sensitivity Analysis and Interest Rate Risk Management

The management team evaluates current interest rate sensitivity on a periodic basis. As part of the evaluation, the Bank reviews the “static” gap position of the organization. Business and pricing strategies are adjusted based upon management’s view of likely interest rate scenarios in conjunction with the current balance sheet structure.

The following table illustrates the interest sensitivity gap position of the Bank as of December 31, 2006. This table presents a position that existed at one particular day that changes continually and is not necessarily indicative of the Bank’s position at any other time. Nonaccrual loans are excluded from the loan category.

Interest Sensitivity Analysis					
December 31, 2006					
Maturing or Repricing					
	Within	4 - 12	1 - 5	Over	
	3 Months	Months	Years	5 Years	Total
(Dollars in Thousands)					
Interest Earning Assets:					
Investment securities	\$ 19	\$ 4,035	\$ 18,120	\$ 7,467	\$ 29,641
Loans	21,847	11,167	53,770	15,188	101,972
Interest bearing deposits	-	-	-	-	-
Federal funds sold	5,265	-	-	-	5,265
Total interest earning assets	27,131	15,202	71,890	22,655	136,878
Interest bearing liabilities:					
Interest-bearing demand deposits	9,922	-	-	-	9,922
Money market deposit accounts	7,277	-	-	-	7,277
Savings accounts	13,316	-	-	-	13,316
Time deposits & IRAs	7,505	29,729	27,558	64	64,856
Total interest-bearing deposits	38,020	29,729	27,558	64	95,371
Federal funds purchased & securities sold	-	-	-	-	-
FHLB Advances	89	266	1,332	12,291	13,978
Other borrowings	-	-	-	-	-
Total interest-bearing liabilities	38,109	29,995	28,890	12,355	109,349
Period Gap	\$ (10,978)	\$ (14,793)	\$ 43,000	\$ 10,300	\$ 27,529
Cumulative Gap	\$ (10,978)	\$ (25,771)	\$ 17,229	\$ 27,529	\$ 27,529
Cumulative Gap / Total Assets	-7.23%	-16.97%	11.34%	18.13%	18.13%

The cumulative gap position within three months was (\$10,978,000) or -7.23% of total assets as of December 31, 2006. The neutral to slightly negative gap suggests the organization sees a more neutral monetary policy and is beginning to place asset maturities a little further out on the curve to capitalize on the higher rate environment. This measurement technique is common in the financial services industry. However, it has limitations and is not the sole tool for measuring interest rate sensitivity.

On a quarterly basis, the Bank performs a complex “Interest Rate Risk Profile” using an independent third party model. This procedure provides a much more accurate measure of sensitivity by incorporating actual portfolio re-pricing data along with current and forecasted market rate environments. As of December 31, 2006, the Bank is in an asset sensitive position as expressed by the one-year cumulative “beta” adjusted gap risk ratio of +1.03%. This interest rate risk position generally forecasts a net interest margin that moves in the same direction as market interest rates.

In mid 2004, the Federal Reserve began a tightening cycle as economic signals showed potential inflationary pressures from accelerating growth. By the end of 2005, the prime-lending rate had risen to 7.25%. Monetary policy continued to deem further ¼% rate hikes necessary during the first six months of 2006 with the most recent move on June 30, 2006. From that date through year’s end, the prime-lending rate held constant at 8.25%.

The Bank expanded its FHLB borrowings during a period of very attractive longer-term rates in the second quarter of 2005 as part of a strategic lending and investing plan designed to capitalize on the flattening yield curve. The Bank began gradually extending maturity durations in the loan and investment portfolios during 2006 utilizing growth in the deposit base as well as the funds borrowed during the previous year. Currently, intermediate maturities in the three to five year term for investments are being targeted. The millennium definitely began by placing challenges on the interest rate risk management process; however, the elections by management to sacrifice earnings and shorten terms to prevent excessive exposure are being rewarded.

Noninterest Income. For the year ended December 31, 2006, noninterest income, exclusive of securities transactions, grew to \$1.49 million, representing a \$60,000 or 4.20% increase over the 2005 level of \$1.43 million. Service charges on deposits were grew slightly during the year and ended with a revenue increase of \$14,000 to \$731,000. The fixed rate mortgage department, despite higher interest rates, experienced revenue growth of \$47,000 from \$380,000 during 2005 to \$427,000 in 2006. Income generated on bank-owned life insurance increased \$8,000 to \$114,000 during 2006 while other income decreased \$10,000 from \$228,000 on December 31, 2005 to \$218,000 on December 31, 2006. This 4.39% decline in other income is reflective of lower net gains recognized on sales of retired equipment.

Noninterest Expense. Noninterest expense in the 2006 fiscal year amounted to \$5.4 million compared to the 2005 level of \$5.0 million. The increase is directly related to expansionary activities occurring in the franchise. The largest component of noninterest expense is salaries and benefits. Salaries and benefits expense for the year ended December 31, 2006 grew \$158,000 or 4.96% to \$3.4 million. The growth in personnel expense is related to rising healthcare costs as well as the continued and planned growth of the bank, additional demands in compliance with more recent laws and regulations, and the ever-expanding product array of the bank. Occupancy and furniture and equipment costs grew \$41,000 over the 2005 level to \$754,000. Other overhead costs grew \$128,000 or 11.23% during 2006 to \$1.3 million. Other overhead costs grew in 2006 as a result of the opening of the Prince George temporary office as well as a greater advertising campaign to both brand and celebrate the Bank’s 100th year anniversary. Compliance and audit costs remain higher due to recent laws and regulations that have mandated the need for expanded audit services.

Income Taxes. For the year ended December 31, 2006, income tax expense declined \$35,000 to \$571,000, a 5.78% decrease over the 2005 level of \$606,000. The lower tax expense is directly related to the decrease in income earned by the Bank for 2006.

Analysis of Financial Condition

Investment Securities. Investment securities available for sale amounted to \$29.2 million as of December 31, 2006, an increase of \$2.9 million or 11.03% in comparison to the December 31, 2005 level of \$26.3 million. No investment securities are classified as held to maturity.

The Bank generally classifies investment securities as available for sale under the classifications required under SFAS No. 115. The portfolio is used to manage excess liquidity and general liquidity needs as well as other rebalancing needs as required by the overall asset / liability position.

The effects of unrealized gains (losses) on the portfolio were an unrealized gain of \$530,000 at December 31, 2006 as compared to an unrealized loss of (\$729,000) at December 31, 2005.

The investment portfolio as of December 31, 2006 contains callable U.S. Agency securities, U.S. Agency mortgage backed securities, corporate debt securities, obligations of state and political subdivisions (tax-exempt municipals), Federal Reserve Bank stock, FHLB stock and other securities. The Bank does not hold any derivative instruments. The Bank's investment strategy includes investments that provide cash flows, stable "locked out" fixed rate investments and callable securities. As part of the overall Asset/Liability strategy, fixed rate securities are purchased that provide an appropriate rate of return consistent with the objective of maintaining a portfolio duration predominately with the five-year area except for tax-exempt issues where longer maturities are necessary to receive a favorable tax-equivalent yield. The Bank actively manages its portfolio duration and composition with the changing market conditions and changes in balance sheet risk management needs. Additionally, the securities may be used to pledge for certain borrowing transactions.

The following table sets forth a summary of the investment securities portfolio as of the periods indicated:

	Investment Securities Portfolio Mix	
	December 31,	
	2006	2005
	(Dollars in Thousands)	
Available For Sale Securities		
U.S. Government Agency Securities	\$ 24,086	\$ 21,785
U.S. Government Agency MBS	476	648
Obligations of State/Political Subdivisions	1,380	885
Corporate Debt Securities	1,964	1,720
Total Available For Sale Securities*	<u>\$ 27,906</u>	<u>\$ 25,038</u>
Restricted Securities		
FHLB & FRB Common Stock	1,231	1,211
Other investments	54	54
Total Restricted Securities	<u>\$ 1,285</u>	<u>\$ 1,265</u>
Total Available For Sale and Restricted Securities	<u><u>\$ 29,191</u></u>	<u><u>\$ 26,303</u></u>

*AFS investments at estimated fair value

The following table summarizes the contractual maturity of investment securities on an estimated fair value basis and their weighted average yield as of December 31, 2006:

Maturities of Investment Securities

	Within		After One		After Five				Total	Yield
	One Year		Year but Within		Years but Within					
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield		
(Dollars in Thousands)										
Available For Sale Securities										
US Government Agency Securities	\$ 2,932	3.08%	\$ 13,841	3.89%	\$ 7,313	5.69%	\$ -	0.00%	\$ 24,086	4.30%
US Government Agency MBS	-	0.00%	476	3.14%	-	0.00%	-	0.00%	476	3.14%
Obligations of State/Political Subdivisions	-	0.00%	220	4.66%	731	4.98%	429	5.70%	1,380	5.26%
Corporate debt and Other securities	985	4.08%	979	5.07%	-	0.00%	-	0.00%	1,964	4.58%
Restricted securities	-	0.00%	-	0.00%	-	0.00%	1,285	5.77%	1,285	5.77%
Total Available For Sale Securities	\$ 3,917	3.33%	\$ 15,516	3.95%	\$ 8,044	5.63%	\$ 1,714	5.75%	\$ 29,191	4.41%

Contractual maturities of mortgage-backed securities (MBS) are reliable indicators of their expected life because mortgage borrowers have the right to prepay mortgages at any time. Additionally, various issues listed above may be redeemed prior to specified contractual maturities by their respective issuers.

Loan Portfolio. The loan portfolio was \$102.0 million as of December 31, 2006, compared to \$94.3 million as of December 31, 2005. Commercial loans represent 7.50% of the loan portfolio or \$7.6 million as of December 31, 2006. Commercial real estate loans (generally owner occupied) were \$47.5 million or 46.60% of the loan portfolio at year's end. Residential real estate loans (home equity and fixed rate trusts) were \$36.0 million or 35.26% of the portfolio while consumer, real estate construction and other loans make up the balance of the loan portfolio as of December 31, 2006. The mix of loans changes somewhat each year as the demand of the Bank's market area changes. Currently, the Bank's market area includes the counties of Dinwiddie, Prince George and Chesterfield as well as the city of Colonial Heights.

The following table summarizes the loan portfolio composition by dollar amount and percentages:

Loan Portfolio Mix

	December 31,			
	2006		2005	
	Amount	Percentage	Amount	Percentage
(Dollars in Thousands)				
Commercial	\$ 7,648	7.50%	\$ 8,357	8.86%
Commercial real estate	47,520	46.60%	42,153	44.69%
Real estate construction	7,929	7.78%	5,185	5.50%
Residential real estate	35,957	35.26%	35,336	37.46%
Consumer	2,918	2.86%	3,288	3.49%
Total loans	\$ 101,972	100.00%	\$ 94,319	100.00%

The following table presents the maturities or re-pricing periods of selected loans outstanding at the year ended December 31, 2006.

Loan Maturity Distribution

	December 31, 2006			
	One Year or Less	After One Year Through Five Years	After Five Years	Total
	(Dollars in Thousands)			
Commercial	\$ 3,687	\$ 3,830	\$ 131	\$ 7,648
Real Estate	12,216	21,654	49,607	83,477
Real Estate Construction	5,955	1,319	655	7,929
Installment	617	1,795	-	2,412
Credit Card Lines	506	-	-	506
	\$ 22,981	\$ 28,598	\$ 50,393	\$ 101,972
Loans with:				
Fixed Rates	\$ 9,665	\$ 26,154	\$ 21,267	\$ 57,086
Variable Rates	13,316	2,444	29,126	44,886
	\$ 22,981	\$ 28,598	\$ 50,393	\$ 101,972

Asset Quality. The Bank believes that the key to success is to maintain high quality in the loan portfolio, the highest yielding assets of the Bank. Weekly loan meetings are held where new commercial loan requests are discussed and existing loans reviewed, closely monitored and rigorously worked in an effort to stop potential problem situations in the early stages and keep past dues at a minimum. The allowance for loan losses was \$1,070,000 as of December 31, 2006 or 1.05% of loans outstanding compared to \$1,025,000 as of December 31, 2005 or 1.09% of outstanding loans.

The following table represents an analysis of the allowance for loan losses for the periods indicated:

Allowance for Loan Losses

	December 31,	
	2006	2005
	(Dollars in Thousands)	
Balance, beginning of period	\$ 1,025	\$ 1,000
Provision for loan losses	46	41
Chargeoffs:		
Commerical	-	18
Consumer	18	19
Total chargeoffs	18	37
Recoveries:		
Commerical	6	8
Consumer	11	13
Total recoveries	17	21
Net chargeoffs	1	16
Balance, end of period	\$ 1,070	\$ 1,025
Allowance for loan losses to total loans	1.05%	1.09%
Net chargeoffs to average loans	0.00%	0.02%

A breakdown of the allowance for loan losses is provided in the following table. However, management of the Bank does not believe that the allowance for loan losses can be fragmented by category with any precision that would be useful to investors. The breakdown of the allowance for loan losses is based primarily upon those factors discussed above in computing the allowance for loan losses as a whole. Because all of these factors are subject to change, the breakdown is not necessarily indicative of the category of future loan losses.

Allocation of the Allowance for Loan Losses

	December 31,	
	2006	2005
	(Dollars in Thousands)	
Commercial	\$ 321	\$ 308
Commercial real estate	214	205
Real estate construction	54	51
Residential real estate	214	205
Consumer	268	256
Total Allowance for Loans Losses	\$ 1,070	\$ 1,025

Past Due Loans and Non-performing Assets. The Bank's business processes closely monitor all individual loans, and the relationship officers are charged with working with customers to resolve potential credit issues in a timely manner with a minimum exposure to the organization. The Bank maintains a policy of adding an appropriate amount to the allowance for loan losses to ensure an adequate reserve based on the portfolio composition, specific credit extended by the Bank and general economic conditions. On December 31, 2006, past dues stood at \$763,000 or 0.75% of year-end loans as compared to \$245,000 or 0.26% of total loans outstanding for December 31, 2005. The Bank is pleased with a delinquency ratio that consistently remains below 1%.

Non-performing assets consist of impaired loans, non-accrual loans and real estate owned by the Bank resulting from a foreclosure proceeding. Loans are placed on non-accrual when a loan is specifically determined to be impaired and/or when principal or interest is delinquent in excess of 90 days. On December 31, 2006, non-performing assets stood at \$1.6 million or 1.53% of year-end loans. This compared to the \$1.8 million non-performing balance, or 1.86%, of total loans outstanding for December 31, 2005.

The following table represents an analysis of the non-performing assets and past due loans for the periods indicated:

Non-Performing Assets and Past Due Loans

	December 31,	
	2006	2005
	(Dollars in Thousands)	
Non-Performing Assets:		
Impaired Loans	\$ 1,294	\$ 1,468
Non-Accruing Loans	\$ 267	\$ 285
Other Real Estate Owned	-	-
Total Non-Performing Assets:	\$ 1,561	\$ 1,753
Past Due Loans:		
Commerical	\$ 64	\$ 20
Real estate	699	205
Consumer	-	20
Total Past Due Loans	\$ 763	\$ 245
Non-Performing Assets to Total Loans	1.53%	1.86%
Past Due Loans to Total Loans	0.75%	0.26%
Past due and Non-Performing Assets to Total Loans	2.28%	2.12%

Deposits. The Bank seeks deposits within the market area by paying competitive interest rates, offering high quality customer service and using technology to deliver deposit services effectively. As of December 31, 2006 the deposit portfolio grew to \$119.3 million, an \$8.6 million increase over the December 31, 2005 level of \$110.7 million. Non-interest bearing demand deposits rose by 4.37%, or \$1.0 million, to a December 31, 2006 level of 23.9 million. Time deposit growth ramped up during 2006 in response to higher rates. These deposit instruments increased \$9.0 million over the December 31, 2005 balance of \$55.9 million to \$64.9 million, an increase of 16.10%. Other interest bearing deposits fell 4.39% or \$1.4 million and ended the year at a level of \$30.5 million. As of December 31, 2006 and 2005, the Bank had no brokered deposits.

The following table details the average amount of, and the average rate paid on, the following primary deposit categories for the periods indicated:

	Average Deposit Balances, Interest Expense and Average Rates					
	Period Ended December 31,					
	2006			2005		
Average Balance	Interest Expense	Average Rate	Average Balance	Interest Expense	Average Rate	
(Dollars in Thousands)						
Interest bearing liabilities:						
Interest-bearing demand deposits	\$ 10,462	\$ 38	0.36%	\$ 11,182	\$ 40	0.36%
Money market deposit accounts	7,625	129	1.69%	8,308	84	1.01%
Savings accounts	13,120	79	0.60%	13,748	82	0.60%
Time deposits	61,832	2,416	3.91%	56,074	1,593	2.84%
Total interest-bearing deposits	<u>93,039</u>	<u>\$ 2,662</u>	<u>2.86%</u>	<u>89,312</u>	<u>\$ 1,799</u>	<u>2.01%</u>
Non-interest bearing deposits	<u>22,787</u>			<u>22,298</u>		
Total deposits	<u>\$ 115,826</u>			<u>\$ 111,610</u>		

The following is a summary of maturity distributions of certificates of deposit as of December 31, 2006.

	Certificate of Deposit Maturity Distribution			
	December 31, 2006			
	Three Months or Less	Three Months to Twelve Months	Over Twelve Months	Total
(Dollars in Thousands)				
Certificates of Deposit:				
Less than \$100,000	\$ 4,923	\$ 23,733	\$ 18,988	\$ 47,644
Greater than or equal to \$100,000	3,709	4,870	8,633	17,212
Total Certificates of Deposit	<u>\$ 8,632</u>	<u>\$ 28,603</u>	<u>\$ 27,621</u>	<u>\$ 64,856</u>

Liquidity. The overall Asset/Liability strategy of the organization takes into account the need for the Bank to maintain adequate liquidity to fund asset growth and deposit runoff. The management of the Bank monitors the liquidity position daily in conjunction with the Federal Reserve position monitoring. The Bank has credit lines both secured and unsecured available from several correspondent banks. Additionally, the Bank may borrow funds from the FHLB. The credit facilities are used in conjunction with the normal deposit strategies, which include pricing changes to increase deposits as necessary. The organization can sell or pledge investment securities to create additional liquidity for the Bank. From time to time the organization may sell or participate out loans to create additional liquidity as required.

The aggregate amounts of borrowed funds at December 31, 2006 and 2005 are \$14,000,000 and \$14,347,780, respectively. At December 31, 2006, the following scheduled debt payments are due:

2007	\$ 333,333
2008	333,333
2009	333,333
2010	333,333
2011	333,333
Thereafter	<u>12,333,335</u>
	<u>\$ 14,000,000</u>

Off-Balance Sheet Transactions. The organization enters into certain financial transactions in the ordinary course of performing traditional banking services that result in off-balance sheet transactions. The off-balance sheet transactions recognized as of December 31, 2006 were commitments to extend credit, letters of credit to secure public deposits of the state and local governments of Virginia, and standby letters of credit. The organization does not have any off-balance sheet subsidiaries or special purpose entities.

A summary of the contract amount of the Bank's exposure to off-balance-sheet risk as of December 31, 2006 and 2005, is as follows:

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ 12,577,565	\$ 10,998,124
Federal Home Loan Bank letter of credit to secure public deposits	2,750,000	2,750,000
Standby letters of credit	630,133	896,334

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. FHLB letters of credit are used by the Bank to collateralize the uninsured portions of funds of the Commonwealth of Virginia and its local governments. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements.

Capital. The Bank is considered "well capitalized" under the risk-based capital guidelines adopted by the various regulatory agencies. Shareholders' equity was \$16.9 million on December 31, 2006 and \$15.8 million on December 31, 2005. The Bank's general policy is to retain the majority of annual earnings to support future organizational growth; however, the Bank has, during the fourth quarter of each year, declared a cash dividend of approximately 25% to 35% of fiscal net earnings. A \$0.25 per common share dividend or 38.02% of earnings was declared in December of 2006, a \$0.03 or 13.64% increase over the December cash dividend per common share of \$0.22 declared in 2005. The December 2005 cash dividend represented 32.05% of fiscal 2005 earnings. While the dividend is greater than the normal percentage earnings payout, the Board believes the improving rate environment will result in stronger margins and greater earning in the years to come sufficient to bring future payout ratios back in line.

The following table shows the Bank's capital ratios and the minimum capital ratios currently required by bank regulators:

Risk Based Capital Analysis

	December 31,		Regulatory Minimum
	2006	2005	
	(Dollars in Thousands)		
Tier 1 Capital:			
Common stock	\$ 3,853	\$ 3,853	
Capital surplus	5,894	5,894	
Retained earnings	7,171	6,035	
Reverse: Unrealized Gains/Losses	296	647	
Total tier 1 capital	17,214	16,429	
Tier 2 Capital:			
Allowance for loan losses	1,070	1,025	
Tier 3 Capital:			
Deduction for Investments in Financial Subsidiaries	(140)	(140)	
Total Risk Based Capital	\$ 18,144	\$ 17,314	
Risk weighted assets	\$ 112,137	\$ 102,422	
Quarterly average assets	\$ 150,344	\$ 144,569	
Capital Ratios:			
Tier 1 risk based capital ratio	15.35%	15.99%	4.0%
Total risk based capital ratio	16.18%	16.79%	8.0%
Leverage ratio	11.45%	11.33%	4.0%

Return on Average Assets and Average Equity

The ratio of net income (losses) to average shareholders' equity and average assets and certain other ratios are as follows:

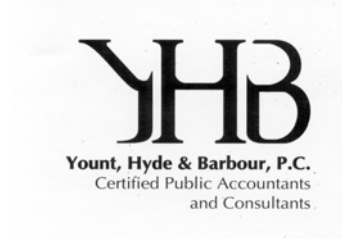
	December 31,	
	2006	2005
	(Dollars in Thousands)	
Average total assets	\$ 147,816	\$ 138,871
Average shareholders' equity	\$ 16,576	\$ 15,853
Net income	\$ 1,267	\$ 1,323
Cash dividends declared	\$ 482	\$ 424
Return on average assets	0.86%	0.95%
Return on average shareholders' equity	7.64%	8.35%
Average shareholders' equity to average total assets	11.21%	11.42%

Impact of Inflation and Changing Prices and Seasonality

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

Unlike industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates have a more significant impact on a financial institution's performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or in the same magnitude as the price of goods and services, since such prices are affected by inflation.

Item 7. Financial Statements



Report of Independent Registered Public Accounting Firm

To the Board of Directors
Bank of McKenney
McKenney, Virginia

We have audited the consolidated balance sheets of Bank of McKenney and subsidiary as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Bank of McKenney and subsidiary as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 13, 2007

BANK OF MCKENNEY AND SUBSIDIARY

Consolidated Balance Sheets

December 31, 2006 and 2005

Assets	<u>2006</u>	<u>2005</u>
Cash and due from banks	\$ 4,179,157	\$ 3,452,836
Federal funds sold	5,265,000	4,241,000
Interest-bearing time deposits in banks	-	3,015,123
Securities available for sale, at fair market value	27,906,220	25,037,717
Restricted investments	1,285,125	1,265,225
Loans, net of allowance for loan losses of \$1,070,000 in 2006 and \$1,025,000 in 2005	100,901,504	93,293,989
Land, premises and equipment, net	6,864,254	6,744,063
Accrued interest receivable	848,180	637,989
Bank owned life insurance	2,877,937	2,764,195
Other assets	<u>1,751,371</u>	<u>1,749,936</u>
 Total assets	 <u>\$ 151,878,748</u>	 <u>\$ 142,202,073</u>
 Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Noninterest-bearing	\$ 23,890,991	\$ 22,904,888
Interest-bearing	<u>95,370,612</u>	<u>87,758,128</u>
Total deposits	\$ 119,261,603	\$ 110,663,016
Borrowed funds	14,000,000	14,347,780
Accrued interest payable	336,015	218,214
Accrued expenses and other liabilities	<u>1,363,477</u>	<u>1,190,566</u>
Total liabilities	<u>\$ 134,961,095</u>	<u>\$ 126,419,576</u>
 Commitments and contingencies		
 Shareholders' Equity		
Common stock, \$2 par value, authorized 2,250,000 shares; issued and outstanding 1,926,656	\$ 3,853,312	\$ 3,853,312
Surplus	5,893,958	5,893,958
Retained earnings	7,467,215	6,682,012
Accumulated other comprehensive loss	<u>(296,832)</u>	<u>(646,785)</u>
Total shareholders' equity	<u>\$ 16,917,653</u>	<u>\$ 15,782,497</u>
 Total liabilities and shareholders' equity	 <u>\$ 151,878,748</u>	 <u>\$ 142,202,073</u>

See Notes to Consolidated Financial Statements.

BANK OF MCKENNEY AND SUBSIDIARY

Consolidated Statements of Income

For the Three Years Ended December 31, 2006

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Interest and Dividend Income			
Interest and fees on loans	\$ 7,755,673	\$ 6,840,912	\$ 6,416,788
Interest and dividends on securities - taxable	1,110,356	753,393	573,923
Interest on securities - nontaxable	44,998	19,446	17,749
Interest on deposits in other banks	59,178	53,681	5,025
Interest on federal funds sold	<u>152,691</u>	<u>214,390</u>	<u>73,748</u>
Total interest and dividend income	<u>\$ 9,122,896</u>	<u>\$ 7,881,822</u>	<u>\$ 7,087,233</u>
Interest Expense			
Interest on deposits	\$ 2,661,855	\$ 1,799,437	\$ 1,506,670
Interest on federal funds purchased	2,064	--	--
Interest on borrowed funds	<u>670,172</u>	<u>494,689</u>	<u>235,808</u>
Total interest expense	<u>\$ 3,334,091</u>	<u>\$ 2,294,126</u>	<u>\$ 1,742,478</u>
Net interest income	\$ 5,788,805	\$ 5,587,696	\$ 5,344,755
Provision for loan losses	<u>45,781</u>	<u>41,464</u>	<u>102,321</u>
Net interest income after provision for loan losses	<u>\$ 5,743,024</u>	<u>\$ 5,546,232</u>	<u>\$ 5,242,434</u>
Noninterest Income			
Service charges on deposit accounts	\$ 730,761	\$ 716,704	\$ 717,838
Secondary market origination fees	426,559	379,628	348,422
Net gain (loss) on sales of available for sale securities	(21,375)	(1,484)	58,422
Bank-owned life insurance	113,742	106,194	71,935
Other operating income	214,168	214,533	222,705
Gain on sale of fixed assets	<u>4,253</u>	<u>13,924</u>	<u>7,628</u>
Total noninterest income	<u>\$ 1,468,108</u>	<u>\$ 1,429,499</u>	<u>\$ 1,426,950</u>
Noninterest Expense			
Salaries and employee benefits	\$ 3,353,810	\$ 3,195,382	\$ 3,008,547
Occupancy expense	312,669	295,263	285,580
Furniture and equipment expense	441,145	417,948	416,790
Data processing	166,162	112,612	134,357
Telecommunications	107,294	93,584	93,951
Stationery and supplies	116,589	106,638	120,838
Audit and accounting fees	150,431	130,740	132,030
Corporate franchise tax	111,167	113,083	103,214
Other operating expenses	<u>614,413</u>	<u>581,581</u>	<u>548,604</u>
Total noninterest expenses	<u>\$ 5,373,680</u>	<u>\$ 5,046,831</u>	<u>\$ 4,843,911</u>
Income before income taxes	\$ 1,837,452	\$ 1,928,900	\$ 1,825,473
Income tax expense	<u>570,585</u>	<u>605,651</u>	<u>576,538</u>
Net income	<u>\$ 1,266,867</u>	<u>\$ 1,323,249</u>	<u>\$ 1,248,935</u>
Earnings per Share			
Net income, basic and diluted	<u>\$ 0.66</u>	<u>\$ 0.69</u>	<u>\$ 0.65</u>

See Notes to Consolidated Financial Statements.

BANK OF MCKENNEY AND SUBSIDIARY

Consolidated Statements of Changes in Shareholders' Equity

For the Three Years Ended December 31, 2006

	<u>Common Stock</u>	<u>Surplus</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Comprehensive Income</u>	<u>Total</u>
Balance at December 31, 2003	\$ 3,853,312	\$ 5,893,958	\$ 4,919,023	\$ (106,130)		\$ 14,560,163
Comprehensive income:						
Net income	--	-	1,248,935	-	\$ 1,248,935	1,248,935
Other comprehensive loss:						
Unrealized holding losses on securities available for sale arising during the period, net of tax benefit of (\$10,953)	--	-	-	-	(21,261)	-
Less reclassification adjustment, net of tax of (\$19,863)	--	-	-	-	(38,559)	-
Other comprehensive loss, net of tax	--	-	-	(59,820)	<u>\$ (59,820)</u>	(59,820)
Total comprehensive income					<u>\$ 1,189,115</u>	
Cash dividends declared (\$.20 per share)	-	-	(385,331)	-		(385,331)
Balance at December 31, 2004	\$ 3,853,312	\$ 5,893,958	\$ 5,782,627	\$ (165,950)		\$ 15,363,947
Comprehensive income:						
Net income	--	-	1,323,249	-	\$ 1,323,249	1,323,249
Other comprehensive loss:						
Unrealized holding losses on securities available for sale arising during the period, net of tax benefit of (\$248,207)	--	-	-	-	(481,814)	-
Add reclassification adjustment, net of tax benefit of \$505	--	-	-	-	979	-
Other comprehensive loss, net of tax benefit	--	-	-	(480,835)	<u>\$ (480,835)</u>	(480,835)
Total comprehensive income					<u>\$ 842,414</u>	
Cash dividends declared (\$.22 per share)	-	-	(423,864)	-		(423,864)
Balance at December 31, 2005	\$ 3,853,312	\$ 5,893,958	\$ 6,682,012	\$ (646,785)		\$ 15,782,497
Comprehensive income:						
Net income	--	-	1,266,867	-	\$ 1,266,867	1,266,867
Other comprehensive income:						
Unrealized holding gains on securities available for sale arising during the period, net of tax of \$173,012	--	-	-	-	335,845	-
Add reclassification adjustment, net of tax benefit of \$7,267	--	-	-	-	14,108	-
Other comprehensive income, net of tax	--	-	-	349,953	<u>\$ 349,953</u>	349,953
Total comprehensive income					<u>\$ 1,616,820</u>	
Cash dividends declared (\$.25 per share)	-	-	(481,664)	-		(481,664)
Balance at December 31, 2006	<u>\$ 3,853,312</u>	<u>\$ 5,893,958</u>	<u>\$ 7,467,215</u>	<u>\$ (296,832)</u>		<u>\$ 16,917,653</u>

See Notes to Consolidated Financial Statements.

BANK OF MCKENNEY AND SUBSIDIARY

Consolidated Statements of Cash Flows
For the Three Years Ended December 31, 2006

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Cash Flows from Operating Activities			
Net income	\$ 1,266,867	\$ 1,323,249	\$ 1,248,935
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	452,343	453,179	457,398
Provision for loan losses	45,781	41,464	102,321
Net (gain) loss on sales of securities available for sale	21,375	1,484	(58,422)
Net (gain) on sale of fixed assets	(4,253)	(13,424)	(7,628)
Net (gain) on sale of other assets	--	(500)	--
Net amortization of premium on securities	20,304	23,417	14,901
Deferred tax (benefit)	(72,920)	(78,708)	(67,496)
Changes in assets and liabilities:			
(Increase) in accrued interest receivable	(210,191)	(115,427)	(68,809)
(Increase) in other assets	(222,536)	(191,078)	(202,841)
Increase in accrued interest payable	117,801	55,091	7,210
Increase in accrued expenses and other liabilities	115,111	179,792	143,903
Net cash provided by operating activities	<u>\$ 1,529,682</u>	<u>\$ 1,678,539</u>	<u>\$ 1,569,472</u>
Cash Flows from Investing Activities			
Net change in interest-bearing deposits in banks	\$ 3,015,123	\$ (3,015,123)	\$ --
Activity in available for sale securities:			
Sales	1,974,600	291,156	5,817,951
Maturities, prepayments and calls	4,285,520	1,350,984	4,664,669
Purchases	(8,640,070)	(6,999,838)	(13,495,775)
Purchase of restricted securities	(19,900)	(458,400)	(151,400)
Purchase of bank owned life insurance	--	--	(1,500,000)
Net increase in loans	(7,653,296)	(627,112)	(7,506,414)
Purchases of land, premises and equipment	(593,281)	(642,840)	(259,518)
Proceeds from sale of fixed assets	25,000	17,900	18,750
Proceeds from sale of other assets	--	1,000	--
Net cash used in investing activities	<u>\$ (7,606,304)</u>	<u>\$ (10,082,273)</u>	<u>\$ (12,411,737)</u>

See Notes to Consolidated Financial Statements.

BANK OF MCKENNEY AND SUBSIDIARY

Consolidated Statements of Cash Flows

(Continued)

For the Three Years Ended December 31, 2006

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Cash Flows from Financing Activities			
Net increase (decrease) in demand and savings deposits	\$ (401,207)	\$ (1,053,002)	\$ 5,793,831
Net increase in time deposits	8,999,794	646,314	1,519,276
Dividends paid	(423,864)	(385,331)	(327,532)
Net change in securities sold under agreements to repurchase	-	-	(17,141)
Federal Home Loan Bank advances	-	10,000,000	-
Payments on FHLB advances and other borrowed funds	<u>(347,780)</u>	<u>(354,297)</u>	<u>(354,666)</u>
Net cash provided by financing activities	<u>\$ 7,826,943</u>	<u>\$ 8,853,684</u>	<u>\$ 6,613,768</u>
Net increase (decrease) in cash and cash equivalents	\$ 1,750,321	\$ 449,950	\$ (4,228,497)
 Cash and Cash Equivalents			
Beginning of year	<u>7,693,836</u>	<u>7,243,886</u>	<u>11,472,383</u>
End of year	<u>\$ 9,444,157</u>	<u>\$ 7,693,836</u>	<u>\$ 7,243,886</u>
 Supplemental Disclosures of Cash Flow Information			
Cash paid during the year for:			
Interest	<u>\$ 3,216,290</u>	<u>\$ 2,239,035</u>	<u>\$ 1,735,268</u>
Income taxes	<u>\$ 613,200</u>	<u>\$ 671,057</u>	<u>\$ 654,150</u>
 Supplemental Disclosures of Noncash Investing and Financing Activities			
Fair value adjustment for securities	<u>\$ 530,232</u>	<u>\$ (728,539)</u>	<u>\$ (90,637)</u>

See Notes to Consolidated Financial Statements.

BANK OF MCKENNEY AND SUBSIDIARY

Notes to Consolidated Financial Statements

Note 1. Summary of Significant Accounting Policies

Organization

Bank of McKenney (the “Bank”) provides depository and lending services for its customers primarily within the counties of Dinwiddie, Chesterfield and Prince George and the city of Colonial Heights in Virginia. Therefore, its loans and deposits are concentrated primarily with the citizens of this area. The Bank is subject to competition from other financial institutions. The Bank is also subject to the regulations of the Board of Governors of the Federal Reserve System and the State Corporation Commission of Virginia, and it undergoes periodic examinations by these regulatory authorities.

McKenney Group, LLC (the “Subsidiary”) is a wholly owned subsidiary of the Bank formed in December of 2000 to provide networking solutions to Virginia community banks. Since its inception, its focus has evolved into a wider array of financial services. The Subsidiary maintains investments in Bankers Title, Bankers Insurance and Community Bankers Securities.

The accounting and reporting policies of the Bank conform to accounting principles generally accepted in the United States of America and predominant practices within the banking industry. The following is a description of the more significant of these policies.

Principles of Consolidation

The consolidated financial statements include the accounts of the Bank’s wholly owned subsidiary, McKenney Group, LLC. All material intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include cash, due from banks and federal funds sold. Generally, federal funds are sold for one-day periods.

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as “held to maturity” and recorded at amortized cost. Securities not classified as held to maturity, including equity securities with readily determinable fair values, are classified as “available for sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Realized gains or losses, determined on the basis of the cost of specific securities sold, are included in earnings.

Purchased premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are determined to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on trade date and are determined using the specific identification method.

Loans

The Bank grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans. The ability of the Bank’s debtors to honor their contracts is dependent upon the real estate and general economic conditions of the Bank’s market area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for the allowance for loan losses. Interest income is accrued on the unpaid principal balance.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. Installment loans are typically charged off no later than 180 days past due. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on non-accrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures.

Land, Premises, and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is charged to expense over the estimated useful lives of the assets, which range from 3 to 20 years for equipment and 18 to 40 years for buildings and improvements, and is computed using the straight-line method for financial reporting purposes and a combination of straight-line and accelerated methods for tax purposes. The costs of major improvements are capitalized, while costs of ordinary maintenance and repairs are charged to expense as incurred.

Use of Estimates

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of foreclosed real estate and deferred tax assets.

Foreclosed Assets

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

Income Taxes

Deferred income tax assets and liabilities are determined using the balance sheet method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

Earnings and Dividends Per Share

Basic earnings per share represent income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. The Bank had no potential common stock as of December 31, 2006, 2005 and 2004.

Earnings and dividends per share are computed based on 1,926,656 weighted average shares outstanding during 2006, 2005 and 2004.

Advertising

The Bank follows the policy of charging the costs of advertising to expense as incurred. Total advertising expense incurred for 2006, 2005 and 2004 was \$71,874, \$61,384 and \$36,573, respectively.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year's method of presentation.

Recent Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 155, "Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140" ("SFAS 155"). SFAS 155 permits fair value measurement of any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. The Statement also clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133. It establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. SFAS 155 also clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Bank does not expect the implementation of SFAS 155 to have a material impact on its consolidated financial statements.

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, "Accounting for Servicing of Financial Assets – an amendment of FASB Statement No. 140" ("SFAS 156"). SFAS 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into certain servicing contracts. The Statement also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable. SFAS 156 permits an entity to choose between the amortization and fair value methods for subsequent measurements. At initial adoption, the Statement permits a one-time reclassification of available for sale securities to trading securities by entities with recognized servicing rights. SFAS 156 also requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. This Statement is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. The Bank does not expect the implementation of SFAS 156 to have a material impact on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements but may change current practice for some entities. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those years. The Bank does not expect the implementation of SFAS 157 to have a material impact on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)" ("SFAS 158"). SFAS 158 requires an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Bank does not have a defined benefit plan or post retirement plan and therefore, the standard did not have an impact on the Bank's consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, "*Accounting for Uncertainty in Income Taxes: An Interpretation of FASB Statement No. 109*" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS 109. The Interpretation prescribes a recognition threshold and measurement principles for the financial statement recognition and measurement of tax positions taken or expected to be taken on a tax return that are not certain to be realized. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Bank does not expect the implementation of FIN 48 to have a material impact on its consolidated financial statements.

In September 2006, the Emerging Issues Task Force issued EITF 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements." This consensus concludes that for a split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with FASB Statement No. 106 (if, in substance, a postretirement benefit plan exists) or APB Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. The consensus is effective for fiscal years beginning after December 15, 2007. The Bank is currently evaluating the effect that EITF No. 06-4 will have on its consolidated financial statements when implemented.

In September 2006, The Emerging Issues Task Force issued EITF 06-5, "Accounting for Purchases of Life Insurance- Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4." This consensus concludes that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. A consensus also was reached that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). The consensus are effective for fiscal years beginning after December 15, 2006. The Bank is currently evaluating the effect that EITF No. 06-5 will have on its consolidated financial statements when implemented.

Note 2. Securities

The amortized cost and fair value of securities, with gross unrealized gains and losses at December 31, 2006 are as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized (Losses)</u>	<u>Fair Value</u>
Available for Sale				
Corporate securities	\$ 2,012,582	\$ --	\$ (48,582)	\$ 1,964,000
Mortgage-backed securities	491,185	--	(15,432)	475,753
Government agencies	24,451,593	61,128	(426,759)	24,085,962
Tax-exempt municipals	1,400,606	531	(20,632)	1,380,505
	<u>\$ 28,355,966</u>	<u>\$ 61,659</u>	<u>\$ (511,405)</u>	<u>\$ 27,906,220</u>

The amortized cost and fair value of securities, with gross unrealized gains and losses at December 31, 2005 are as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized (Losses)</u>	<u>Fair Value</u>
Available for Sale				
Corporate securities	\$ 2,021,037	\$ --	\$ (300,787)	\$ 1,720,250
Mortgage-backed securities	670,056	--	(22,440)	647,616
Government agencies	22,425,528	4	(640,778)	21,784,754
Tax-exempt municipals	901,074	-	(15,977)	885,097
	<u>\$ 26,017,695</u>	<u>\$ 4</u>	<u>\$ (979,982)</u>	<u>\$ 25,037,717</u>

The contractual maturities of investment securities classified as available for sale at December 31, 2006 are shown below. Expected maturities may differ from contractual maturities because mortgages underlying the mortgage-backed securities may be called or prepaid without any penalties.

	<u>Cost</u>	<u>Value</u>
Available for Sale		
Maturing within one year	\$ 3,987,952	\$ 3,916,972
Maturing after one year, but within five years	15,930,697	15,515,879
Maturing after five years, but within ten years	8,004,518	8,044,653
Maturing after ten years	432,799	428,716
	<u>\$ 28,355,966</u>	<u>\$ 27,906,220</u>

Proceeds from sales of securities available for sale for the years ended December 31, 2006, 2005 and 2004, amounted to \$1,974,600, \$291,156 and \$5,817,951, respectively. Gross realized gains (losses) amounted to (\$21,375), (\$1,484) and \$58,422, respectively.

Notes to Consolidated Financial Statements

There were no securities pledged to secure public deposits or for other purposes required by law at December 31, 2006 or December 31, 2005. The Bank utilizes a Letter of Credit through the Federal Home Loan Bank of Atlanta (the "FHLB") for meeting the collateral requirements of such deposits.

Due to certain banking relationships with the Federal Reserve Bank of Richmond, the FHLB of Atlanta and Community Bankers' Bank, the Bank had invested \$1,285,125 and \$1,265,225 at December 31, 2006 and 2005, respectively, in restricted investments required by these entities. These investments are carried at cost, which approximates redemption value.

The Bank had securities in its portfolio at December 31, 2006 and 2005 that reflected an unrealized loss in value. These unrealized losses have been evaluated and are considered to be temporary impairments of the value of the issues. A summary of these securities as of December 31, 2006 and 2005 is as follows:

Description	December 31, 2006					
	Total		Less than 12 Months		12 Months or Greater	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Government agencies	\$ 17,745,652	\$ (426,759)	\$ 3,634,395	\$ (5,605)	\$ 14,111,257	\$ (421,154)
Mortgage-backed	475,753	(15,432)	-	-	475,753	(15,432)
Corporate	1,964,000	(48,582)	-	-	1,964,000	(48,582)
Tax exempt municipals	1,124,582	(20,632)	428,716	(4,082)	695,866	(16,550)
Unrealized Loss Positions	<u>\$ 21,309,987</u>	<u>\$ (511,405)</u>	<u>\$ 4,063,111</u>	<u>\$ (9,687)</u>	<u>\$ 17,246,876</u>	<u>\$ (501,718)</u>

Description	December 31, 2005					
	Total		Less than 12 Months		12 Months or Greater	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Government agencies	\$ 19,790,377	\$ (640,778)	\$ 7,315,195	\$ (105,960)	\$ 12,475,182	\$ (534,818)
Mortgage-backed	647,616	(22,440)	18,588	(213)	629,028	(22,227)
Corporate	1,720,250	(300,787)	861,250	(153,883)	859,000	(146,904)
Tax exempt municipals	885,097	(15,977)	700,977	(15,097)	184,120	(880)
Unrealized Loss Positions	<u>\$ 23,043,340</u>	<u>\$ (979,982)</u>	<u>\$ 8,896,010</u>	<u>\$ (275,153)</u>	<u>\$ 14,147,330</u>	<u>\$ (704,829)</u>

Management evaluates securities for other-than-temporary impairments at least on a quarterly basis and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At December 31, 2006, the securities identified above with unrealized losses consisted of fifteen U.S. Agency issues, one governmental mortgage pool issue, two corporate issues, and six issues of different municipalities. Two corporate credits, General Motors Acceptance Corporation and Ford Motor Credits remained as sub-investment grade. With the issuance being through the financing arms and the maturity being short (within two years), the losses have substantially diminished during the year and no permanent impairments are expected at this time in either of the issues. All agency, mortgage and municipal bonds were purchased during or after 2003, and the unrealized losses reflect changes in the current interest rate environment as well as the issues' maturities. No principal is expected to be lost, and the unrealized losses, primarily due to interest rates, are considered temporary in nature. In analyzing an issuer's financial condition, management considers whether the federal government or its agencies issued the securities, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. As management has the ability and intent to hold debt securities until maturity, or for the foreseeable future if classified as available for sale, no declines are deemed to be other than temporary.

Note 3. Loans

The composition of loans at December 31, 2006 and 2005 is as follows:

	<u>2006</u>	<u>2005</u>
Commercial	\$ 7,647,649	\$ 8,356,909
Real estate	83,476,487	77,489,089
Real estate-construction	7,928,957	5,184,578
Installment	2,412,289	2,743,851
Credit cards	<u>506,122</u>	<u>544,562</u>
Total loans	\$ 101,971,504	\$ 94,318,989
Less: Allowance for loan losses	<u>1,070,000</u>	<u>1,025,000</u>
Loans, net	<u>\$ 100,901,504</u>	<u>\$ 93,293,989</u>

Note 4. Allowance for Loan Losses

Activity in the allowance for loan losses for the years ended December 31, 2006, 2005 and 2004 is as follows:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Balance, beginning	\$ 1,025,000	\$ 1,000,000	\$ 900,000
Loans charged off	(18,213)	(37,515)	(13,182)
Recoveries	17,432	21,051	10,861
Provision	45,781	41,464	102,321
Balance, ending	<u>\$ 1,070,000</u>	<u>\$ 1,025,000</u>	<u>\$ 1,000,000</u>

The following is a summary of information pertaining to impaired loans at December 31, 2006, 2005 and 2004:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Impaired loans with a valuation allowance	\$ 1,561,311	\$ 1,752,716	\$ 1,604,844
Impaired loans without a valuation allowance	<u>--</u>	<u>--</u>	<u>--</u>
Total impaired loans	<u>\$ 1,561,311</u>	<u>\$ 1,752,716</u>	<u>\$ 1,604,844</u>
Valuation allowance related to impaired loans	<u>\$ 436,000</u>	<u>\$ 642,500</u>	<u>\$ 615,000</u>
Average investment in impaired loans	<u>\$ 1,656,537</u>	<u>\$ 1,633,576</u>	<u>\$ 819,226</u>
Interest income recognized	<u>\$ 125,675</u>	<u>\$ 114,876</u>	<u>\$ 58,305</u>

There were no non-accrual loans excluded from impaired loan disclosure under FASB 114 at December 31, 2006, 2005 and 2004.

Note 5. Land, Premises and Equipment

Land, premises, and equipment at December 31, 2006 and 2005 are composed of the following:

	2006	2005
Land	\$ 1,612,431	\$ 1,459,598
Bank building and improvements	5,513,704	5,505,444
Furniture and equipment	2,107,373	2,130,869
Automobiles	346,509	336,136
Total land, premises and equipment	\$ 9,580,017	\$ 9,432,047
Less accumulated depreciation	2,715,763	2,687,984
Net land, premises and equipment	\$ 6,864,254	\$ 6,744,063

Depreciation expense for the years ended December 31, 2006, 2005 and 2004 amounted to \$452,343, \$453,179 and \$457,398, respectively.

Note 6. Deposits

The aggregate amounts of time deposits in denominations of \$100,000 or more at December 31, 2006 and 2005 are \$17,212,043 and \$14,457,622, respectively.

At December 31, 2006, the scheduled maturities of time deposits are as follows:

2007	\$ 37,234,433
2008	17,217,964
2009	4,221,487
2010	2,325,535
2011	3,792,306
Thereafter	63,837
	\$ 64,855,562

Note 7. Borrowings

The Bank has a FHLB fifteen-year amortizing note with an original balance of \$5,000,000 and interest paid monthly at a fixed rate of 4.79%. The Bank also has a FHLB ten-year non-amortizing note in the amount of \$10,000,000 and interest paid monthly at a fixed rate of 4.70%. The current aggregate balances of these notes at December 31, 2006 and 2005 were \$14,000,000 and \$14,333,333, respectively. The loans are secured by a blanket agreement that includes all qualifying 1-4 family residential mortgage loans. As of December 31, 2006, the Bank held \$25,899,311 in qualifying mortgages.

Notes to Consolidated Financial Statements

During the year, the two owner-financed unsecured notes for the purchase of 4.076 acres in Dinwiddie County, Virginia reached the end of their respective repayment schedules. The terms had called for monthly payments of \$1,053 at a fixed interest rate of 8.0%. The balance as of December 31, 2005 was \$14,447.

At December 31, 2006, the Bank had \$17,586,116 available under open lines of credit with other financial institutions and the FHLB.

The contractual maturities of borrowings for the year ended December 31, 2006 are as follows:

2007	\$	333,333
2008		333,333
2009		333,333
2010		333,333
2011		333,333
Thereafter		<u>12,333,335</u>
		<u>\$ 14,000,000</u>

Note 8. Income Taxes

Income tax expense for the years ended December 31, 2006, 2005 and 2004 consists of the following:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Current tax expense	\$ 643,505	\$ 684,359	\$ 644,034
Deferred tax (benefit)	<u>(72,920)</u>	<u>(78,708)</u>	<u>(67,496)</u>
	<u>\$ 570,585</u>	<u>\$ 605,651</u>	<u>\$ 576,538</u>

Income tax expense differs from the amounts computed by applying the U. S. Federal income tax rate of 34% in 2006, 2005 and 2004 to earnings before income taxes as a result of the following:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Computed "expected" tax expense	\$ 624,734	\$ 655,826	\$ 620,660
Tax-exempt interest	(13,331)	(5,892)	(5,564)
Bank-owned life insurance	(38,672)	(36,106)	(24,458)
Other, net	<u>(2,146)</u>	<u>(8,177)</u>	<u>(14,100)</u>
	<u>\$ 570,585</u>	<u>\$ 605,651</u>	<u>\$ 576,538</u>

Notes to Consolidated Financial Statements

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2006 and 2005 are presented below:

	2006	2005
Deferred Tax Assets		
Net unrealized loss on securities		
available for sale	\$ 152,914	\$ 333,192
Allowance for loan losses	296,252	280,687
Deferred compensation plans	233,305	205,083
Nonaccrual loan interest	15,201	8,733
Deferred tax assets	\$ 697,672	\$ 827,695
 Deferred Tax Liabilities		
Depreciation	\$ 112,591	\$ 135,256
Deferred tax liabilities	\$ 112,591	\$ 135,256
Net deferred tax assets	\$ 585,081	\$ 692,439

Note 9. Employee Benefit Plan

The Bank has a 401(k) defined contribution plan available to substantially all employees. To be eligible for the plan, employees must have been employed for twelve months prior to an entry date into the plan, which is defined as the first day of each plan year and the first day of the seventh month of each plan year. An employee must be at least twenty years of age to be eligible under the plan.

Under this plan, the Bank is required to match participating employees' contributions up to specified limits. The Bank may also, at its discretion, make additional contributions to the plan out of net profits in an amount determined by the Board of Directors. During 2006, 2005 and 2004, 401(k) plan contributions totaled \$159,632, \$137,552 and \$107,273, respectively.

Note 10. Executive Supplemental Income Plans

A Deferred Compensation Income Agreement has been adopted for a key employee, which provides that benefits are to be paid in monthly installments for 10 years following retirement or death. The employee has met the required service period specified under the agreement and will be entitled to the payments at age 65. Salary Continuation Agreements have also been adopted on the key employee, providing benefits to be paid in monthly installments for 15 years following retirement or death. Under the agreements, the employee will be entitled to full benefits at age 65 provided service to the Bank occurs until age 55.

In August 2004, the key employee assigned to the Bank the benefits under a split-dollar life insurance agreement held with the Bank and in exchange therefore entered into a supplemental retirement plan agreement with the Bank. Pursuant to the terms of the agreement, the Bank is granting the key employee a supplemental retirement income benefit equal to \$1,500 monthly for 10 years. Eligibility to start receiving the benefit begins upon reaching the age of 65 or at which time the key employee retires from the Bank in accordance with the Bank's retirement policies. Under the agreement, the key employee becomes 100% vested in the retirement benefit upon the earlier of the age of 62, death or disability, involuntary termination of employment without cause or upon a change in control of the Bank. If the key employee terminates employment with the Bank before the age of 62 for any reason other than as set forth in the preceding sentence, this entire retirement benefit is forfeited.

The executive supplemental income benefit expense for 2006, 2005 and 2004 based on the present value of the retirement benefits amounted to \$84,005, \$77,360 and \$58,751, respectively. The Plans are unfunded; however, life insurance has been acquired on the life of this key employee in amounts sufficient to discharge the obligations of the agreement.

Note 11. Related Party Transactions

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 and affiliated companies in which they are principal shareholders (commonly referred to as related parties) on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. These persons and firms were indebted to the Bank for loans totaling \$1,193,084 and \$2,921,786 at December 31, 2006 and 2005, respectively. During 2006, total principal additions were \$1,377,696 and total principal payments were \$3,106,398. Total deposit relationships for related party persons and firms of \$1,562,438 were reported as of December 31, 2006.

Note 12. Fund Restrictions and Reserve Balance

Federal and state regulations limit the amount of dividends the Bank can pay without obtaining prior approval and, additionally, federal regulations require that the Bank maintain a ratio of total capital to assets, as defined by regulatory authorities. As of December 31, 2006, the Bank could declare dividends of \$2,548,192 without prior approval.

As a member of the Federal Reserve System, the Bank must maintain certain average reserve balances. For the final weekly reporting period in the years ended December 31, 2006 and 2005, the aggregate amounts of daily average required balances are approximately \$592,000 and \$671,000, respectively.

Note 13. Capital Requirements

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2006 and 2005, that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2006, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios are also presented in the table.

	<u>Actual</u>		<u>Minimum Capital Requirement</u>		<u>Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
(Amount in Thousands)						
As of December 31, 2006:						
Total Capital (to Risk Weighted Assets)	\$18,144	16.2%	\$ 8,971	8.0%	\$11,214	10.0%
Tier 1 Capital (to Risk Weighted Assets)	\$17,214	15.4%	\$ 4,485	4.0%	\$ 6,728	6.0%
Tier 1 Capital (to Average Assets)	\$17,214	11.5%	\$ 6,014	4.0%	\$ 7,517	5.0%
As of December 31, 2005:						
Total Capital (to Risk Weighted Assets)	\$17,314	16.8%	\$ 8,194	8.0%	\$10,242	10.0%
Tier 1 Capital (to Risk Weighted Assets)	\$16,429	16.0%	\$ 4,097	4.0%	\$ 6,145	6.0%
Tier 1 Capital (to Average Assets)	\$16,429	11.3%	\$ 5,783	4.0%	\$ 7,228	5.0%

Note 14. Commitments and Contingencies

In the normal course of business, there are outstanding various commitments and contingent liabilities which are not reflected in the accompanying financial statements. The Bank does not anticipate any material losses as a result of these transactions. See Note 15 with respect to financial instruments with off-balance-sheet risk.

Note 15. Financial Instruments With Off-Balance-Sheet Risk

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. 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 balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit 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.

A summary of the contract amount of the Bank's exposure to off-balance-sheet risk as of December 31, 2006 and 2005, is as follows:

	<u>2006</u>	<u>2005</u>
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	\$ 12,577,565	\$ 10,998,124
Federal Home Loan Bank letter of credit to secure public deposits	2,750,000	2,750,000
Standby letters of credit	630,133	896,334

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

The Treasurer of the Commonwealth of Virginia permits FHLB letters of credit as instruments to collateralize the uninsured portions of public funds. The Bank utilizes this methodology to secure public deposits and currently has released all other securities from pledged obligations.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Note 16. Concentration Risk

The Bank maintains its cash accounts in several correspondent banks. As of December 31, 2006, deposits in excess of amounts insured by the Federal Deposit Insurance Corporation were \$962,744.

Note 17. Fair Value of Financial Instruments and Interest Rate Risk

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Therefore, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Bank.

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

Cash and cash equivalents: The carrying amounts of cash and short-term instruments approximate fair values.

Interest-bearing deposits in banks: The carrying amounts of interest-bearing deposits maturing within 90 days approximate their fair values. Fair values of other interest-bearing deposits are estimated using discounted cash flow analyses based on current rates for similar deposit types.

Securities: Fair values for securities, excluding restricted investments, are based on quoted market prices. The carrying value of restricted investments approximates fair value based on the redemption provisions of the restricted investments.

Loans receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for certain mortgage loans (e.g., one-to-four family residential), credit card loans, and other consumer loans are based on quoted market prices of similar loans sold in conjunction with securitization transactions, adjusted for differences in loan characteristics. Fair values for other loans (e.g., commercial real estate and investment property mortgage loans, commercial and industrial loans) are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-performing loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposit liabilities: The fair values disclosed for demand deposits (e.g., interest and non-interest checking, savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings: The carrying amounts of borrowings under repurchase agreements and other short-term borrowings maturing within ninety days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements. The fair values of the Bank's long-term borrowings are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements.

Accrued interest: The carrying amounts of accrued interest approximate fair values.

Off-balance-sheet instruments: The fair value of commitments to extend credit is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreements and the present credit worthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of standby letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. At December 31, 2006 and 2005, fair values of loan commitments and standby letters of credit were immaterial.

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

	December 31, 2006		December 31, 2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(in thousands)			
Financial assets:				
Cash and cash equivalents	\$ 9,444	\$ 9,444	\$ 7,694	\$ 7,694
Interest bearing deposits in banks	-	-	3,015	3,010
Securities available-for-sale	27,906	27,906	25,038	25,038
Restricted investments	1,285	1,285	1,265	1,265
Loans, net	100,902	99,174	93,294	92,092
Accrued interest receivable	848	848	638	638
Financial liabilities:				
Deposits	119,262	119,210	110,663	110,342
Borrowings	14,000	14,005	14,348	14,381
Accrued interest payable	336	336	218	218

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

Item 8. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure

None

Item 8A. Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-KSB. Based on that evaluation, our principal executive officer and principal financial officer have concluded that these controls and procedures are effective. There were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

Disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, as adopted by the Federal Reserve, is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Item 8B. Other Information

None

Item 9. Directors, Executive Officers, Promoters, Control Persons and Corporate Governance; Compliance with Section 16(a) of the Exchange Act

All required information on the executive officers and directors of the Bank is incorporated herein by reference from the Bank's 2007 definitive proxy statement for the annual meeting of shareholders ("Definitive Proxy Statement"), and such proxy statement is expected to be filed with the Federal Reserve within 120 days after the end of the fiscal year to which this report relates.

The following is information on the only executive officer of the Bank who is not a director of the Bank:

<u>Name (Age)</u>	<u>Principal Occupation Over Last Five Years</u>
James B. Neville, Jr. (43)	Executive Vice President & Chief Financial Officer

Item 10. Executive Compensation

This information is incorporated herein by reference from the Bank's Definitive Proxy Statement.

Item 11. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

This information is incorporated herein by reference from the Bank's Definitive Proxy Statement.

Item 12. Certain Relationships and Related Transactions, and Director Independence

This information is incorporated herein by reference from the Bank's Definitive Proxy Statement.

Item 13. Exhibits

The following exhibits are filed as part of this Form 10-KSB and this list includes the Exhibit Index:

<u>Exhibit Number</u>	<u>Description</u>	<u>Page</u>
3.1	Articles of Incorporation of Bank of McKenney	*
3.2	Amended and Restated Bylaws of Bank of McKenney	**
10.1	Employment Agreement, dated December 8, 1992, by and between Bank of McKenney and Richard M. Liles	*
10.2	Split-Dollar Life Insurance Agreement (as amended), dated February 1, 1989, by and between Bank of McKenney and Richard M. Liles	*
10.3	Deferred Compensation Agreement, dated February 1, 1989, between Bank of McKenney and Richard M. Liles	*
10.4	Deferred Compensation Agreement, dated February 1, 1993, between Bank of McKenney and Richard M. Liles	*
10.5	Form of Change in Control Employment Agreement between Bank of McKenney and each of the following officers: James B. Neville, Jr., Ruth M. Wray, Lynda P. Cunningham, and Mark H. Stevens	***
21.1	McKenney Group, LLC (a Virginia corporation)	*
31.1	CEO Section 302 Certification	†
31.2	CFO Section 302 Certification	†
32	Section 906 Certification	†

* Incorporated herein by reference from the Bank's Registration Statement on Form 10-SB, filed with the Board of Governors of the Federal Reserve System on September 9, 2002.

** Incorporated herein by reference from the Bank's Annual Report on Form 10-KSB for the year ended December 31, 2003, filed with the Board of Governors of the Federal Reserve System on March 29, 2004.

*** Incorporated herein by reference from the Bank's Annual Report on Form 10-KSB for the year ended December 31, 2004, filed with the Board of Governors of the Federal Reserve System on March 8, 2005.

† Filed herewith.

Item 14. Principal Accountant Fees and Services

This information is incorporated herein by reference from the Bank's Definitive Proxy Statement.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BANK OF MCKENNEY

Date: March 13th, 2007

By: /s/ Richard M. Liles
Richard M. Liles
President and Chief Executive Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Capacity</u>	<u>Date</u>
<u>/s/ Richard M. Liles</u> Richard M. Liles	President and Chief Executive Officer (principal executive officer)	March 13 th , 2007
<u>/s/ James B. Neville, Jr.</u> James B. Neville, Jr.	Executive Vice President and Chief Financial Officer (principal financial officer)	March 13 th , 2007
<u>/s/ W. D. Allen III</u> W.D. Allen, III	Director	March 13 th , 2007
<u>/s/ Harry D. Baird III</u> Harry D. Baird, III	Director	March 13 th , 2007
<u>/s/ Joan D. Clarke</u> Joan D. Clarke	Director	March 13 th , 2007
<u>/s/ L. M. Harrison, Jr.</u> L.M. Harrison, Jr.	Director	March 13 th , 2007
<u>/s/ Rudy L. Hawkins</u> Rudy L. Hawkins	Director	March 13 th , 2007
<u>/s/ Joseph W. Lyle</u> Joseph W. Lyle	Director	March 13 th , 2007
<u>/s/ Edward B. Titmus</u> Edward B. Titmus	Director	March 13 th , 2007

CERTIFICATIONS

I, Richard M. Liles, certify that:

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

/s/ Richard M. Liles
Richard M. Liles
President and Chief Executive Officer

Date: March 13th, 2007

CERTIFICATIONS

I, James B. Neville, Jr., certify that:

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

/s/ James B. Neville, Jr.
 James B. Neville, Jr.
 Executive Vice President and Chief Financial Officer

Date: March 13th, 2007

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

In connection with the Annual Report of Bank of McKenney (the “Bank”) on Form 10-KSB for the period ending December 31, 2006 as filed with the Board of Governors of the Federal Reserve System on the date hereof (the “Report”), the undersigned Chief Executive Officer and Chief Financial officer of the Bank hereby certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002 that based on their knowledge and belief: 1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and 2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Bank as of and for the periods covered in the Report.

/s/ Richard M. Liles

Richard M. Liles
President and Chief Executive Officer

/s/ James B. Neville, Jr.

James B. Neville, Jr.
Executive Vice President and Chief Financial Officer

Dated: March 13th, 2007