



**TOUCHMARK**  
B A N C S H A R E S , I N C.

**2012**

**Annual Report to Shareholders**

March 2013

Dear Shareholders:

I am pleased to report to you that 2012 has been a very good year for your company. Touchmark accrued record earnings of \$4.36 million dollars for the year or \$1.26 per share. The board and management have worked very hard to accomplish a consecutive second year of profitable returns for your investment. Furthermore, the condition of the bank has been better than it has ever been. Today, Touchmark is a healthy, sound, safe and profitable company, well positioned to grow with, and in spite of, the slow recovery.

There are certain changes in the company and our subsidiary bank in the next several months which I would like to keep you abreast of. First, we have changed the core operating system for the bank at the end of February; Touchmark National Bank now has a more robust operating system which is capable of offering many added conveniences to our customers. Technologies such as remote deposit capture, mobile banking and online cash management make it possible for clients to manage their money without utilizing physical locations. For this reason, the board has made the decision to close our branches. Abbotts Bridge Branch was closed in February and the Doraville Branch will be closed effective the end of June. While the financial impact from the branch closing will have a negative effect for 2013 because of various accounting and other elements, significant positive impact is anticipated for 2014.

Another change we will anticipate is our President and Chief Executive Officer, Pin Pin Chau, has notified the board that she will be retiring by the end of June as per contract arrangement. The board of directors wishes to thank Mrs. Chau for her hard work and many contributions to our success in the past three years. The board has named Jorge Forment, our Executive Vice President and Chief Financial Officer, as her successor to be effective July 1, 2013. Our Comptroller Kellie Pressnall, Vice President, will succeed Mr. Forment as Chief Financial Officer. We anticipate a very orderly and smooth transition and expect that the company will continue to thrive under the new team.

On behalf of the board of directors and management, I wish to thank you our shareholders for your support as we look forward to another challenging but rewarding year.

Very truly yours,

J.J. Shah, MD



Chairman,  
Board of Director

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**CONSOLIDATED FINANCIAL STATEMENTS  
WITH  
INDEPENDENT AUDITOR'S REPORT**

**DECEMBER 31, 2012 AND 2011**

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**December 31, 2012 and 2011**

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REPLY TO:  
2800 Century Parkway  
Suite 900  
Atlanta, Georgia 30345  
800-823-1224  
FAX 404-214-1302  
atlanta@nicholscauley.com

### INDEPENDENT AUDITOR'S REPORT

Board of Directors  
Touchmark Bancshares, Inc.  
Alpharetta, Georgia

We have audited the accompanying consolidated financial statements of Touchmark Bancshares, Inc. and its subsidiary, which comprise the consolidated balance sheet as of December 31, 2012, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

#### *Management's Responsibility for the Consolidated Financial Statements*

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

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### *Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Touchmark Bancshares, Inc. and its subsidiary as of December 31, 2012, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

#### *Other Matter*

The consolidated financial statements of Touchmark Bancshares, Inc. and its subsidiary for the year ended December 31, 2011 were audited by another auditor who expressed an unmodified opinion on those consolidated financial statements on March 30, 2012.

*Nichols, Cauley & Associates, LLC*

Atlanta, Georgia  
March 12, 2013

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Consolidated Balance Sheets  
December 31, 2012 and 2011**

	2012	2011
<u>ASSETS</u>		
Cash and due from banks	\$ 2,020,540	\$ 2,509,157
Federal funds sold	125,000	325,000
Interest-bearing accounts with other banks	4,342,125	6,729,905
Securities available for sale	28,887,181	36,134,645
Restricted stock	1,635,450	1,478,500
Loans held for sale	148,658	248,658
Loans, less allowance for loan losses of \$1,787,109 and \$1,745,400, respectively	78,192,768	74,268,936
Accrued interest receivable	429,459	434,178
Premises and equipment	2,326,270	2,486,685
Foreclosed real estate	3,861,419	5,375,473
Land held for sale	2,409,023	2,409,023
Other assets	4,027,360	200,806
Total assets	\$ 128,405,253	\$ 132,600,966
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Liabilities:		
Deposits:		
Non-interest bearing demand	\$ 9,040,274	\$ 9,119,354
Interest-bearing	71,769,626	85,197,277
Total deposits	80,809,900	94,316,631
Accrued interest payable	19,477	36,011
Federal funds purchased	3,019,000	-
Federal Home Loan Bank advances	14,750,000	12,500,000
Other liabilities	257,529	523,263
Total liabilities	98,855,906	107,375,905
Stockholders' equity:		
Preferred stock, no par value, 10,000,000 shares authorized, none issued	-	-
Common stock, \$.01 par value, 50,000,000 shares authorized, 3,465,391 issued and outstanding	34,654	34,654
Paid-in capital	36,230,955	36,189,165
Accumulated deficit	(7,063,950)	(11,428,518)
Accumulated other comprehensive income	347,688	429,760
Total stockholders' equity	29,549,347	25,225,061
Total liabilities and stockholders' equity	\$ 128,405,253	\$ 132,600,966

See accompanying independent auditor's report and notes to the consolidated financial statements.

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Consolidated Statements of Income  
For the Years Ended December 31, 2012 and 2011**

	2012	2011
Interest income:		
Loans, including fees	\$ 4,801,794	\$ 4,618,195
Investment income	711,046	1,396,183
Federal funds sold	1,801	1,135
Total interest income	5,514,641	6,015,513
Interest expense:		
Deposits	735,850	1,193,653
Federal Home Loan Bank advances	301,261	273,407
Other borrowings	4,917	4,917
Total interest expense	1,042,028	1,471,977
Net interest income	4,472,613	4,543,536
Provision for loan losses	525,000	209,563
Net interest income after provision for loan losses	3,947,613	4,333,973
Noninterest income:		
Service charges on deposit accounts and other fees	37,272	53,658
Gain on sale of securities available for sale	197,533	287,271
Gain on sale of SBA loans	1,267,455	991,497
Gain on sale of foreclosed real estate	155,203	-
Other noninterest income	724,865	85,973
Total noninterest income	2,382,328	1,418,399
Noninterest expense:		
Salaries and employee benefits	2,558,612	2,751,178
Occupancy and equipment	638,829	657,580
Loss on sale of loans held for sale	-	102,809
Loss on fair value mark of derivative instrument	9,435	66,713
Other operating expense	2,774,262	2,106,132
Total noninterest expense	5,981,138	5,684,412
Income before taxes	348,803	67,960
Income tax benefit	4,015,765	-
Net income	\$ 4,364,568	\$ 67,960
Basic earnings per share	\$ 1.26	\$ 0.02
Diluted earnings per share	\$ 1.26	\$ 0.02
Dividends per share	\$ -	\$ -

See accompanying independent auditor's report and notes to the consolidated financial statements.

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Consolidated Statements of Comprehensive Income  
For the Years Ended December 31, 2012 and 2011**

	2012	2011
Net income	\$ 4,364,568	\$ 67,960
Other comprehensive income (loss):		
Securities available for sale:		
Unrealized holding gains arising during the period	75,037	1,674,323
Reclassification adjustment for gains realized in income	(197,533)	(287,271)
Tax effect	40,424	(457,727)
Other comprehensive income (loss)	(82,072)	929,325
Comprehensive income	\$ 4,282,496	\$ 997,285

See accompanying independent auditor's report and notes to the consolidated financial statements.



**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Consolidated Statements of Stockholders' Equity  
For the Years Ended December 31, 2012 and 2011**

	Outstanding Shares of Common Stock	Common Stock	Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 2010	3,465,391	\$ 34,654	\$ 36,091,663	\$ (11,496,478)	\$ (499,565)	\$ 24,130,274
Stock based compensation expense	-	-	97,502	-	-	97,502
Net income	-	-	-	67,960	-	67,960
Change in unrealized gain on securities available for sale, net	-	-	-	-	929,325	929,325
Balance, December 31, 2011	3,465,391	34,654	36,189,165	(11,428,518)	429,760	25,225,061
Stock based compensation expense	-	-	41,790	-	-	41,790
Net income	-	-	-	4,364,568	-	4,364,568
Change in unrealized losses on securities available for sale, net	-	-	-	-	(82,072)	(82,072)
Balance, December 31, 2012	<u>3,465,391</u>	<u>\$ 34,654</u>	<u>\$ 36,230,955</u>	<u>\$ (7,063,950)</u>	<u>\$ 347,688</u>	<u>\$ 29,549,347</u>

See accompanying independent auditor's report and notes to the consolidated financial statements.

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Consolidated Statements of Cash Flows  
For The Years Ended December 31, 2012 and 2011**

	2012	2011
Cash flow from operating activities:		
Net income	\$ 4,364,568	\$ 67,960
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	272,462	278,460
Net amortization	571,871	344,290
Provision for loan losses	525,000	209,563
Valuation allowance for loans held for sale	100,000	-
Valuation allowance for foreclosed real estate	612,298	-
Stock compensation expense	41,790	97,502
Gain on sale of securities available for sale	(197,533)	(287,271)
Gain on sale of SBA loans	(1,267,455)	(991,497)
Proceeds from sale of loans held for sale	-	167,528
Loss on sale of loans held for sale	-	102,809
Gain on sale of foreclosed real estate	(155,203)	-
Decrease in interest receivable	4,719	204,525
Deferred income taxes	(4,015,765)	-
Decrease in interest payable	(16,534)	(45,736)
Decrease in other assets	229,635	315,540
Increase (decrease) in other liabilities	(265,734)	88,904
Net cash provided by operating activities	804,119	552,577
Cash flow from investing activities:		
Decrease (increase) in federal funds sold, net	200,000	(325,000)
Decrease (increase) in interest bearing accounts	2,387,780	(4,169,618)
Purchase of securities available for sale	(13,683,950)	(13,020,586)
Proceeds from sale, call, paydown and maturity of securities available for sale	20,434,580	27,351,114
Purchase of restricted stock	(156,950)	(38,600)
Proceeds from sale of foreclosed real estate	2,273,220	17,713
Loan originations and collections, net	(4,397,638)	4,691,408
Purchase of premises and equipment	(112,047)	(25,216)
Net cash provided by investing activities	6,944,995	14,481,215

See accompanying independent auditor's report and notes to the consolidated financial statements.

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Consolidated Statements of Cash Flows  
For The Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
Cash flow from financing activities:		
Net decrease in deposits	(13,506,731)	(12,818,109)
Repayment of secured borrowings	-	(2,027,311)
Increase in federal funds purchased, net	3,019,000	-
Proceeds from Federal Home Loan Bank advances	<u>2,250,000</u>	<u>1,100,000</u>
Net cash used by financing activities	<u>(8,237,731)</u>	<u>(13,745,420)</u>
Net change in cash	(488,617)	1,288,372
Cash at the beginning of the period	<u>2,509,157</u>	<u>1,220,785</u>
Cash at the end of the period	<u>\$ 2,020,540</u>	<u>\$ 2,509,157</u>
Supplemental disclosures of cash flow information -		
Interest paid	<u>\$ 1,058,562</u>	<u>\$ 1,517,713</u>
Non cash activities:		
Transfer of loan principal to foreclosed real estate	<u>\$ 1,216,261</u>	<u>\$ 5,101,809</u>

See accompanying independent auditor's report and notes to the consolidated financial statements.

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The accounting and reporting policies of Touchmark Bancshares, Inc. conform to generally accepted accounting principles and with general practices within the banking industry. The following is a description of the more significant of those policies that the Company follows in preparing and presenting its financial statements.

Reporting Entity and Nature of Operations

Touchmark Bancshares, Inc. (the “Company”), a Georgia corporation, was established on April 3, 2007 for the purpose of organizing and managing Touchmark National Bank, (the “Bank”). The Company is a one-bank holding company with respect to its subsidiary, Touchmark National Bank. The Bank was opened with the purpose of serving as a community bank in Gwinnett County, north Fulton and DeKalb counties and surrounding areas in the state of Georgia.

The Bank operates branches in Alpharetta, Duluth, and Doraville, Georgia. The Company’s primary sources of revenue are derived from the Bank’s loans to customers within its geographical area and it’s investment portfolio. The Company’s earnings are primarily dependent upon its net interest income, which is determined by (i) the difference between yields earned on interest-earning assets and rates paid on interest-bearing liabilities (“interest rate spread”) and (ii) the relative amounts of interest-earning assets and interest-bearing liabilities outstanding. The Company’s interest rate spread is affected by regulatory, economic, and competitive factors that influence interest rates, loan demand and deposit flows. The Company, like other community banks, is vulnerable to an increase in interest rates to the extent that interest-bearing liabilities mature or re-price more rapidly than interest-earning assets.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiary. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates in the Preparation of Financial Statements

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

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans, the valuation of real estate acquired in connection with foreclosure or in satisfaction of loans, fair market value of securities, derivatives and financial instruments, the valuation of deferred tax assets, and the disclosure of contingent assets and liabilities. In connection with the determination of the allowances for losses on loans management obtains independent appraisals for significant properties.

Management believes that the allowance for losses on loans is adequate. While management uses available information to recognize losses on loans, future additions to the allowances may be necessary based on changes in local economic conditions.

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Cash and Cash Equivalents

Cash and cash equivalents include cash and due from banks. Cash flows from deposits, Federal funds sold, secured borrowings, and originations and collections of loans are reported net. The Bank is required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank based on a percentage of deposits. The total of those reserve balances was approximately \$148,000 at December 31, 2012.

Investment Securities

Securities, including equity securities with readily determinable fair values, are classified as securities available for sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss).

Purchase premiums and discounts are recognized in interest income using methods approximating the interest method over the terms of the securities. A decline in the market value of any security below cost that is deemed other than temporary results in a charge to earnings and the establishment of a new cost basis for the security. The general standards of accounting for other than temporary impairment (OTTI) losses require the recognition of an OTTI loss in earnings only when an entity (1) intends to sell the debt security; (2) more likely than not will be required to sell the security before recovery of its amortized cost basis or (3) does not expect to recover the entire amortized cost basis of the security. Realized gains and losses for securities are included in earnings and are derived using the specific identification method for determining the amortized cost of securities sold as of the trade date.

Periodically, all available for sale securities are evaluated for other-than-temporary impairment (OTTI) in accordance with U.S. generally accepted accounting principles, which specifies requirements for recognizing OTTI on debt securities, presentation of OTTI losses, and modifies and expands disclosure about OTTI for debt securities.

A debt security is considered to be other-than-temporarily impaired if the present value of cash flows expected to be collected are less than the security's amortized cost basis (the difference defined as the credit loss) or if the fair value of the security is less than the security's amortized cost basis and the investor intends, or more-likely-than-not will be required, to sell the security before recovery of the security's amortized cost basis, the charge to earnings is limited to the amount of the credit loss. Any remaining difference between fair value and amortized cost (the difference defined as the non-credit portion) is recognized in other comprehensive income. Otherwise, the entire difference between fair value and amortized cost basis is charged to earnings.

Restricted Stock

Restricted stock consists of Federal Reserve Bank, Federal Home Loan Bank of Atlanta (FHLB), and the Independent Bankers Bank of Florida stock, which represents an equity interest in these entities and is recorded at cost. These stocks do not have a readily determinable fair value because ownership is restricted and lacks a market.

The amount of FHLB stock held by the Company is required by the FHLB to be maintained and is based on membership requirements and terms of advance agreements. The Company periodically evaluates its FHLB stock investment for possible impairment based on, among other things, the capital adequacy of the FHLB and its overall financial condition. The Federal Housing Finance Agency, the regulator of the FHLB, requires it to

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Restricted Stock

maintain a total capital-to-asset ratio of at least 4%. At September 30, 2012, the FHLB Atlanta's regulatory capital ratio amounted to 5.56%. Regulatory capital ratio is regulatory capital stock plus retained earnings as a percentage of total assets at year end.

The Company believes its holdings in the stock is ultimately recoverable at par value and therefore determined that FHLB, Federal Reserve Bank, and Independent Bankers Bank of Florida stock was not other-than-temporarily impaired. In addition, the Bank has ample liquidity and does not require redemption of its restricted stock in the foreseeable future.

Loan Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal, adjusted for any charge-offs, the allowance for loan losses, deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

Interest on loans is credited to income on a daily basis based upon the principal amount outstanding. Loan origination fees and certain direct origination costs, less the costs associated with closing the loan, are capitalized and recognized as an adjustment of the yield of the related loan. The related loan origination costs are recognized as expense at the time the loan is originated. The net effect on the financial condition and results of operations of not deferring the net fees and costs is not significant.

The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed, unless management believes that the accrued interest is recoverable through the liquidation of collateral. Interest income is subsequently recognized only to the extent cash payments are received. Loans are returned to accrual status when all the principal and interest amounts contractually due are reasonably assured of repayment within a reasonable time frame.

Loan delinquencies are determined by comparing contractual requirements to the timing of payments received from the borrower. The policies and procedures related to nonaccrual and delinquent loans are applied to all outstanding loans.

Allowance for Loan Losses

The allowance for loan losses is increased by provision charges to income and decreased by charge-offs (net of recoveries). Loans are charged against the allowance for loan losses when management believes the collection of the principal is unlikely. The allowance for loan losses is maintained at a level believed adequate by management to absorb estimated probable inherent loan losses and estimated losses relating to specifically identified loans. Management's periodic evaluation of the adequacy of the allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates that are susceptible to significant change including the amounts and timing of future cash flows expected to be received on impaired loans.

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Allowance for Loan Losses

While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for losses on loans. Such agencies may require the Company to recognize additions to the allowance based on their judgment about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowance for losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

The allowance for loan losses may consist of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the collateral value less selling costs, present value of expected cash flows, or the observable market price of the impaired loan is lower than the carrying value of the loan.

A loan is considered impaired when, based on current information and events, it is probable the Company will be unable to collect the scheduled payments of principal and 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.

Impaired loans are measured 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 estimated fair value of the collateral, less selling costs, if the loan is collateral dependent. The amount of impairment, if any, and any subsequent changes are included in the allowance for loan losses or charged-off if determined to be uncollectible. By the time a loan becomes probable for foreclosure it has been charged down to fair value, less estimated costs to sell.

General allowances are established for non-impaired loans. These loans are assigned a loan category, and the allocated allowance for loan losses is determined based upon the loss percentage factors that correspond to each loan category.

Loss percentage factors are based on historical loss experience adjusted for qualitative factors. The qualitative factors consider among other things, credit concentrations, recent levels and trends in delinquencies and nonaccrual loans, and growth in the loan portfolio. The occurrence of certain events could result in changes to the loss factors. Accordingly, these loss factors are reviewed periodically and modified as necessary.

The general reserves are determined based on consideration of historic loss data, the various risk characteristics of each loan segment, and whether the loans are within or outside the Company's general market area. Risk characteristics relevant to each portfolio segment are as follows:

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Allowance for Loan Losses

Construction and development loans —Loans in this segment primarily include real estate development loans for which payment is derived from sale of the property as well as construction projects in which the property will ultimately be used by the borrower. Credit risk is affected by cost overruns, time to sell at an adequate price, and market conditions.

Real estate - mortgage —The Company generally does not originate loans with a loan-to-value ratio greater than 85% and does not grant subprime loans. Loans in this segment are dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates will have an effect on the credit quality in the segment.

Commercial real estate —Loans in this segment are owner occupied business properties and non-owner occupied business income-producing properties. The underlying cash flows generated by the properties and the businesses occupying the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates and decreased owner cash flows, which in turn, will have an effect on the credit quality in this segment. Management monitors the cash flows of these borrowers.

Commercial and industrial loans — Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment.

Other loans – Loans in the segment are made to individuals and are generally secured by personal property and/or personal guaranties. Repayment is expected from the cash flows of the individual which is affected by the overall economy with specific regards to the unemployment rate.

Unallocated allowances relate to inherent losses that are not otherwise evaluated in the specific and general allowances. The qualitative factors associated with unallocated allowances are subjective and require a high degree of management judgment. These factors include the inherent imprecision in mathematical models and credit quality statistics, recent economic uncertainty, losses incurred from recent events, lagging or incomplete data and the significant factors affecting the real estate market.

Significant Group Concentrations of Credit Risk

A substantial portion of the Company's loan portfolio is to customers in Gwinnett, Dekalb, north Fulton, and south Forsyth counties and surrounding areas in Georgia. The ultimate collectability of a substantial portion of the portfolio is therefore susceptible to changes in the economic and market condition in and around this area.

The nature of the Company's business requires that it maintain amounts due from banks, which at times may exceed federally insured limits. The Company has not experienced any losses in such accounts, and management works to mitigate risk associated with its correspondent institutions. Amounts due from banks are typically maintained in demand deposit accounts which are fully insured.



**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Loans Held for Sale

Loans intended for sale in the secondary market are stated at the lower of cost or estimated fair value. Net unrealized losses, if any, are recognized through a valuation allowance. Changes in the valuation allowance are included in the determination of net income (loss) for the period in which the change occurs. A valuation allowance of \$100,000 was established as of December 31, 2012. No valuation allowance was required as of December 31, 2011.

Transfers of Financial Assets

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

Derivatives

The Company's interest rate risk management strategy incorporates the use of derivative instruments to minimize fluctuations in net income (loss) that are caused by interest rate volatility. The goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net interest margin is not, on a material basis, adversely affected by movements in interest rates. The Company views this strategy as a prudent management of interest rate risk, such that net income (loss) is not exposed to undue risk presented by changes in interest rates.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation, computed principally on the straight-line method over the estimated useful lives of the assets.

Maintenance and repairs that do not extend the useful life of the premises and equipment are charged to expense. The useful lives of premises and equipment are as follows:

<u>Asset Type</u>	<u>Estimated Useful Life</u>
Buildings	40 years
Leasehold improvements	lesser of lease term or expected life
Furniture, fixtures and equipment	3-9 years

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**Notes to Consolidated Financial Statements**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Foreclosed Real Estate

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value less selling costs at the date of foreclosure establishing a new cost basis. Any write down to fair value at the time of foreclosure is charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Costs of improvements are capitalized, whereas costs relating to holding foreclosed real estate and subsequent adjustment to the value are expensed.

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the 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 and considers any uncertain tax positions.

A valuation allowance for deferred tax assets is required when it is more likely than not that some portion or all of the deferred tax asset will not be realized. In assessing the realization of the deferred tax assets, management considers the scheduled reversals of deferred tax liabilities, projected future taxable income (in the near-term based on current projections), and tax planning strategies.

The Company recognizes accrued interest associated with uncertain tax positions as part of interest expense and penalties associated with uncertain tax positions as part of other expenses. As of December 31, 2012 and 2011, there were no accrued interest and penalties associated with uncertain tax positions.

The operating results of the Company and its subsidiary are included in consolidated income tax returns.

Comprehensive Income (Loss)

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in our 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 our net income, are components of comprehensive income (loss).

Stock Based Compensation

The Company maintains a share-based employee compensation plan for grants of equity based compensation to key personnel. The Company accounts for such share-based payment based on the fair value of such as of the date of grant. Upon issuance of share based payment awards, compensation cost is recognized in the consolidated financial statements of the Company for all share-based payments granted, based on the grant date fair value over the requisite service period of the awards. The stock based compensation plan is described more fully in Note 17.

**TOUCHMARK BANCSHARES, INC.  
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**Notes to Consolidated Financial Statements**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding. Diluted earnings per share are computed by dividing net income by the sum of the weighted average number of shares of common stock outstanding and potential common shares. Potential common shares consist of stock options and warrants. Refer to Note 10 for a summary of the components used to calculate the basic and diluted earnings per share.

Financial Instruments

In the ordinary course of business the Company enters into off balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable.

Fair Values of Financial Instruments

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Quoted market prices, if available, are utilized as estimates of the fair values of financial instruments. Since no quoted market prices exist for a significant part of the Company's financial instruments, the fair values of such instruments have been derived based on management's assumptions, the estimated amount and timing of future cash flows and estimated discount rates.

The estimation methods for individual classifications of financial instruments are described in Note 14. Different assumptions could significantly affect these estimates. Accordingly, net realizable values could be materially different from the estimates presented. In addition, the estimates are only indicative of the value of individual financial instruments and should not be considered an indication of the fair value of the combined Company.

Reclassifications

Certain amounts have been reclassified in the 2011 consolidated financial statements for them to be more comparable to the 2012 consolidated financial statements.

Recent Accounting Pronouncements

In October 2012, the FASB issued Accounting Standards Update No. 2012-04, *Technical Corrections and Improvements* (ASU 2012-04). ASU 2012-04 prescribes technical corrections and improvements to the Accounting Standards Codification for source literature amendments, guidance clarification and reference corrections, and relocated guidance within the Accounting Standards Codification. Certain amendments in ASU 2012-04 do not have transition guidance, and these amendments were effective upon issuance. For nonpublic companies, the amendments that are subject to transition guidance are effective for fiscal periods beginning after December 15, 2013. The Company is evaluating the impact of ASU 2012-04; however, it is not expected to have a significant impact on the Company's financial position or results of operations.

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**Notes to Consolidated Financial Statements**

2. RISK FACTORS

The Company's operations, profitability, cash flows, capital and liquidity are affected by various risk factors, including, but not necessarily limited to, interest-rate risk, credit risk and risk from geographic concentration of lending activities. Management attempts to manage interest rate risk through various asset/liability management techniques designed to match maturities and rate terms and structures of assets and liabilities. Loan policies and administration are designed to provide assurance that loans will only be granted to credit-worthy borrowers, although credit losses are expected to occur resulting from factors beyond the control of the Company.

The Company's operations, profitability, cash flows, capital and liquidity are significantly dependent on economic conditions and related uncertainties. In addition, the Company is affected, directly and indirectly, by domestic and international economic and political conditions and by governmental monetary and fiscal policies.

The Company is particularly sensitive to changes in economic conditions and related uncertainties in Georgia because the Company derives substantially all of its loans, deposits and other business from this area. The subsidiary Bank of the Company is a community bank and as such, is mandated by the Community Reinvestment Act and other regulations to conduct most of its lending activities within the geographic area where it is located. As a result, the Bank and its borrowers may be especially vulnerable to the consequences of changes in the local economy. As a result, the Bank and its borrowers may be especially vulnerable to the consequences of changes in the local economy which may include further deterioration in commercial and residential real estate.

The Company is subject to extensive federal and state governmental supervision and regulation, which are intended primarily for the protection of depositors. In addition, the Company is subject to changes in federal and state laws, as well as changes in regulations, governmental policies and accounting principles. The effects of any such potential changes cannot be predicted but could adversely affect the business, operations, profitability, cash flows, capital and liquidity of the Company in the future.

The Company is subject to vigorous competition in all aspects and areas of business from banks and other financial institutions, including savings and loan associations, savings banks, finance companies, credit unions and other providers of financial services, such as money market mutual funds, brokerage firms, consumer finance companies and insurance companies. The Company also competes with nonfinancial institutions, including retail stores that maintain their own credit programs and governmental agencies that make available low cost or guaranteed loans to certain borrowers. Certain competitors are larger financial institutions with substantially greater resources, lending limits, larger branch systems and a wider array of commercial banking services.

In addition, the Bank conducts business daily with correspondent banks. These banks are not immune to financial difficulties. Regulation F "Limitations on Interbank Liabilities" requires the Bank to establish and maintain written policies and procedures to prevent excessive exposure to any individual correspondent banking relationship relative to the financial condition of such correspondent. The Company is vulnerable to the financial difficulties of any of its major correspondent banking relationships directly and indirectly.

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**Notes to Consolidated Financial Statements**

**3. SECURITIES AVAILABLE FOR SALE:**

The amortized cost, gross unrealized gains and losses, and estimated fair value of investments securities at December 31, 2012 and 2011, are summarized as follows:

<u>December 31, 2012</u>	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
U.S. Government-sponsored enterprises (GSEs)*	\$ 3,314,296	\$ 22,083	\$ -	\$ 3,336,379
State and municipal securities	5,399,865	226,068	(11,509)	5,614,424
Mortgage-backed GSE residential	19,654,083	328,077	(45,782)	19,936,378
	<u>\$ 28,368,244</u>	<u>\$ 576,228</u>	<u>\$ (57,291)</u>	<u>\$ 28,887,181</u>
<u>December 31, 2011</u>				
U.S. Government-sponsored enterprises (GSEs)*	\$ 2,000,000	\$ 12,163	\$ -	\$ 2,012,163
State and municipal securities	4,140,071	233,654	-	4,373,725
Mortgage-backed GSE residential	29,353,141	420,639	(25,023)	29,748,757
	<u>\$ 35,493,212</u>	<u>\$ 666,456</u>	<u>\$ (25,023)</u>	<u>\$ 36,134,645</u>

\* Such as Federal Home Mortgage Association, Federal Home Loan Mortgage Corporation, Federal Home Loan Banks, and Small Business Administration

The amortized cost and estimated fair value of investment securities at December 31, 2012, by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in one year or less	\$ 7,450,200	\$ 7,556,268
Due after one year but less than five years	12,886,388	13,103,010
Due after five years but less than ten years	6,379,212	6,431,120
Due after ten years	1,652,444	1,796,783
	<u>\$ 28,368,244</u>	<u>\$ 28,887,181</u>

**TOUCHMARK BANCSHARES, INC.  
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**3. SECURITIES AVAILABLE FOR SALE:**

For the purpose of the maturity table, mortgage-backed securities, which are not due at a single maturity date, have been allocated over maturity groupings based on the weighted-average contractual maturities of underlying collateral. The mortgage-backed securities may mature earlier than their weighted-average contractual maturities because of principal prepayments.

The Company had gross gains on sales of securities of \$200,589 and gross losses on sales of securities of \$3,056 during the year ended December 31, 2012. The Company had gross gains on sales of securities of \$324,884 and gross losses on sales of securities of \$37,613 during the year ended December 31, 2011.

Securities with a carrying value of \$8,038,283 and \$7,591,789 at December 31, 2012 and 2011, respectively, were pledged to secure public deposits, Federal Home Loan Bank advances, and for other purposes required, or permitted by law. Taxable interest income on investments was \$540,318 and \$1,034,820 for the years ended December 31, 2012 and 2011, respectively.

Information pertaining to securities with gross unrealized losses at December 31, 2012 and 2011 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less than Twelve Months		More than Twelve Months		Total	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
December 31, 2012:						
State and municipal securities	\$ (11,509)	\$ 1,201,380	\$ -	\$ -	\$ (11,509)	\$ 1,201,380
Mortgage-backed GSE residential	(37,430)	5,297,320	(8,352)	556,363	(45,782)	5,853,683
	<u>\$ (48,939)</u>	<u>\$ 6,498,700</u>	<u>\$ (8,352)</u>	<u>\$ 556,363</u>	<u>\$ (57,291)</u>	<u>\$ 7,055,063</u>
December 31, 2011:						
Mortgage-backed GSE residential	\$ (25,023)	\$ 6,383,330	\$ -	\$ -	\$ (25,023)	\$ 6,383,330
	<u>\$ (25,023)</u>	<u>\$ 6,383,330</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (25,023)</u>	<u>\$ 6,383,330</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation.

At December 31, 2012, 10 of 55 debt securities have unrealized losses with aggregate depreciation of 0.81% from the Company's amortized cost basis. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. Although the issuers have shown declines in earnings and a weakened financial condition as a result of the weakened economy, no credit issues have been identified that cause management to believe the declines in market value are other than temporary. As management has the ability to hold debt securities until maturity, or for the foreseeable future, no declines are deemed to be other than temporary.

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3. SECURITIES AVAILABLE FOR SALE:

*State and municipal securities.* The Company's unrealized losses on one investment in state and municipal securities was caused by changes in interest rates. This security will continue to be monitored as part of the Company's periodic impairment analysis, but is expected to perform even if the rating agencies reduce the credit rating in the bond issuer. Accordingly, it is expected that the security will not be settled at a price less than the amortized cost basis of the Company's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company has no immediate plans to sell the investment, and because it is not more likely than not that the Company will be required to sell the investment before recovery of the amortized cost basis, which may be maturity, management does not consider this investment to be other-than-temporarily impaired at December 31, 2012.

*Mortgage-backed securities GSE residential.* The unrealized losses on the Company's investment in nine mortgage-backed securities GSE residential were caused by interest rate increases. The contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost basis of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2012.

4. LOANS AND ALLOWANCE FOR LOAN LOSSES:

The composition of loans as of December 31, 2012 and 2011 is summarized as follows:

	2012	2011
Construction and development	\$ 8,647,308	\$ 9,255,356
Real estate - mortgage	6,030,849	7,676,754
Commercial real estate	61,028,334	51,405,126
Commercial and industrial	4,119,048	7,282,319
Other	257,746	516,849
	80,083,285	76,136,404
Unearned loan origination income	(103,408)	(122,068)
Allowance for loan losses	(1,787,109)	(1,745,400)
Loans, net	\$ 78,192,768	\$ 74,268,936

For purposes of the disclosures required pursuant to the adoption of amendments to ASC 310, the loan portfolio was disaggregated into segments. A portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for loan losses. There are five loan portfolio segments that include construction and development, real estate — mortgage, commercial real estate, commercial and industrial, and other.

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES:

*Construction and Development*

Loans in this segment include real estate development loans for which the source of repayment is the sale of the property as well as construction projects in which the property will ultimately be used by the borrower. Total construction and development loans as of December 31, 2012 were 10.80% of the total loan portfolio.

*Real Estate - Mortgage*

These are loans secured by real estate mortgages. Total real estate mortgage loans as of December 31, 2012 were 7.53% of the total loan portfolio.

*Commercial Real Estate*

The commercial real estate portfolio represents the largest category of the Company's loan portfolio. These loans are owner occupied business properties or non-owner occupied business income-producing properties. The loans are dependent upon the borrower's cash flow, either from the borrower's business or rental income of the underlying property. Total commercial real estate loans as of December 31, 2012 were 76.21% of the total loan portfolio.

*Commercial and Industrial*

Loans in this segment are made to businesses and are generally secured by business assets. Total commercial and industrial loans as of December 31, 2012 were 5.14% of the total loan portfolio.

*Other*

Loans in this segment are made to individuals and are secured by personal assets or unsecured. Total other loans as of December 31, 2012 were 0.32% of the total loan portfolio.

In the normal course of business, the Bank may sell and purchase loan participations to and from other financial institutions and related parties. Loan participations are typically sold to comply with the legal lending limits per borrower as imposed by regulatory authorities. The participations are sold without recourse and the Bank imposes no transfer or ownership restrictions on the purchaser. At December 31, 2012 and 2011 the Bank had \$32,028,563 and \$24,421,302 of participations sold, and \$10,199,189 and \$10,424,268 participations purchased. The majority of the participations sold are Small Business Administration guaranteed loans for which the guaranteed portion was sold.



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**4. LOANS AND ALLOWANCE FOR LOAN LOSSES:**

The allowance for loan losses as of December 31, 2012, by portfolio segment, is as follows:

	Construction and Development	Real Estate - Mortgage	Commercial Real Estate	Commercial and Industrial	Other	Unallocated	Total
Allowance for loan losses:							
Beginning balance	\$ 564,176	\$ 145,288	\$ 572,763	\$ 145,418	\$ 28,438	\$ 289,317	\$ 1,745,400
Charge-offs	-	(122,261)	(269,710)	-	(169,881)	-	(561,852)
Recoveries	-	78,561	-	-	-	-	78,561
Provision	(324,695)	(2,225)	781,466	(37,014)	144,007	(36,539)	525,000
Ending balance	<u>\$ 239,481</u>	<u>\$ 99,363</u>	<u>\$ 1,084,519</u>	<u>\$ 108,404</u>	<u>\$ 2,564</u>	<u>\$ 252,778</u>	<u>\$ 1,787,109</u>
Ending balance: individually evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Ending balance: collectively evaluated for impairment	<u>\$ 239,481</u>	<u>\$ 99,363</u>	<u>\$ 1,084,519</u>	<u>\$ 108,404</u>	<u>\$ 2,564</u>	<u>\$ 252,778</u>	<u>\$ 1,787,109</u>
Ending balance: loans acquired with deteriorated credit quality	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Gross loans:							
Ending balance	<u>\$ 8,647,308</u>	<u>\$ 6,030,849</u>	<u>\$ 61,028,334</u>	<u>\$ 4,119,048</u>	<u>\$ 257,746</u>	<u>\$ -</u>	<u>\$ 80,083,285</u>
Ending balance: individually evaluated for impairment	<u>\$ 2,910,000</u>	<u>\$ -</u>	<u>\$ 542,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,452,000</u>
Ending balance: collectively evaluated for impairment	<u>\$ 5,737,308</u>	<u>\$ 6,030,849</u>	<u>\$ 60,486,334</u>	<u>\$ 4,119,048</u>	<u>\$ 257,746</u>	<u>\$ -</u>	<u>\$ 76,631,285</u>
Ending balance: loans acquired with deteriorated credit quality	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

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**4. LOANS AND ALLOWANCE FOR LOAN LOSSES:**

The allowance for loan losses as of December 31, 2011, by portfolio segment, is as follows:

	Construction and Development	Real Estate - Mortgage	Commercial Real Estate	Commercial and Industrial	Other	Unallocated	Total
Allowance for loan losses:							
Beginning balance	\$ 1,259,996	\$ 68,905	\$ 1,933,810	\$ 156,457	\$ 43,207	\$ -	\$ 3,462,375
Charge-offs	(93,190)	-	(1,833,348)	-	-	-	(1,926,538)
Recoveries	-	-	-	-	-	-	-
Provision	(602,630)	76,383	472,301	(11,039)	(14,769)	289,317	209,563
Ending balance	<u>\$ 564,176</u>	<u>\$ 145,288</u>	<u>\$ 572,763</u>	<u>\$ 145,418</u>	<u>\$ 28,438</u>	<u>\$ 289,317</u>	<u>\$ 1,745,400</u>
Ending balance: individually evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Ending balance: collectively evaluated for impairment	<u>\$ 564,176</u>	<u>\$ 145,288</u>	<u>\$ 572,763</u>	<u>\$ 145,418</u>	<u>\$ 28,438</u>	<u>\$ 289,317</u>	<u>\$ 1,745,400</u>
Ending balance: loans acquired with deteriorated credit quality	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Gross loans:							
Ending Balance	<u>\$ 9,255,356</u>	<u>\$ 7,676,754</u>	<u>\$ 51,405,126</u>	<u>\$ 7,282,319</u>	<u>\$ 516,849</u>	<u>\$ -</u>	<u>\$ 76,136,404</u>
Ending balance: individually evaluated for impairment	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,251,803</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,251,803</u>
Ending balance: collectively evaluated for impairment	<u>\$ 9,255,356</u>	<u>\$ 7,676,754</u>	<u>\$ 50,153,323</u>	<u>\$ 7,282,319</u>	<u>\$ 516,849</u>	<u>\$ -</u>	<u>\$ 74,884,601</u>
Ending balance: loans acquired with deteriorated credit quality	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES:

Impaired loans as of December 31, 2012 and 2011, by portfolio segment, are as follows:

	Unpaid Total Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance
<u>As of December 31, 2012</u>					
Construction and development	\$ 2,910,000	\$ 2,910,000	\$ -	\$ 2,910,000	\$ -
Real estate - mortgage	-	-	-	-	-
Commercial real estate	811,710	542,000	-	542,000	-
Commercial and industrial	-	-	-	-	-
Other	-	-	-	-	-
Total	<u>\$ 3,721,710</u>	<u>\$ 3,452,000</u>	<u>\$ -</u>	<u>\$ 3,452,000</u>	<u>\$ -</u>
<u>As of December 31, 2011</u>					
Construction and development	\$ -	\$ -	\$ -	\$ -	\$ -
Real estate - mortgage	-	-	-	-	-
Commercial real estate	3,925,636	1,251,803	-	1,251,803	-
Commercial and industrial	-	-	-	-	-
Other	-	-	-	-	-
Total	<u>\$ 3,925,636</u>	<u>\$ 1,251,803</u>	<u>\$ -</u>	<u>\$ 1,251,803</u>	<u>\$ -</u>

	Year Ended December 31, 2012		Year Ended December 31, 2011	
	Average Recorded Investment	Income Recognized	Average Recorded Investment	Income Recognized
	Construction and development	\$ 970,000	\$ 116,639	\$ -
Real estate - mortgage	-	-	-	-
Commercial real estate	926,643	-	1,495,372	-
Commercial and industrial	-	-	-	-
Other	-	-	-	-
Total	<u>\$ 1,896,643</u>	<u>\$ 116,639</u>	<u>\$ 1,495,372</u>	<u>\$ -</u>

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**4. LOANS AND ALLOWANCE FOR LOAN LOSSES:**

A primary credit quality indicator for financial institutions is delinquent balances. Delinquencies are updated on a daily basis and are continuously monitored. Loans are placed on nonaccrual status as needed based on repayment status and consideration of accounting and regulatory guidelines. Nonaccrual balances are updated and reported on a daily basis. Following are the delinquent amounts, by portfolio segment, as of December 31, 2012 and 2011:

	Current	30 - 89 Days	Accruing Greater Than 90 Days	Total Accruing Past Due	Non-accrual	Total Financing Receivables
<u>December 31, 2012</u>						
Construction and development	\$ 8,647,308	\$ -	\$ -	\$ -	\$ -	\$ 8,647,308
Real estate - mortgage	6,030,849	-	-	-	-	6,030,849
Commercial real estate	60,486,334	-	-	-	542,000	61,028,334
Commercial and industrial	4,119,048	-	-	-	-	4,119,048
Other	257,746	-	-	-	-	257,746
<u>December 31, 2011</u>						
Construction and development	\$ 9,255,356	\$ -	\$ -	\$ -	\$ -	\$ 9,255,356
Real estate - mortgage	7,676,754	-	-	-	-	7,676,754
Commercial real estate	50,153,323	-	-	-	1,251,803	51,405,126
Commercial and industrial	7,282,319	-	-	-	-	7,282,319
Other	516,849	-	-	-	-	516,849

The Company utilizes a nine grade internal loan rating system for its loan portfolio as follows:

- Loans rated 1-4 (Pass) - Loans in these categories have low to average risk.
- Loans rated 5 (Internal Watch List) - These assets raise some concern due to either prior financial or collateral problems, or recent developing conditions, and thus warrant closer monitoring and review than “pass” assets.
- Loans rated 6 (Special Mention) - These assets constitute an undue and unwarranted credit risk but not to the point of justifying a substandard classification.
- Loans rated 7 (Substandard) - A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any.
- Loans rated 8 (Doubtful) - An asset classified as doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.
- Loans rated 9 (Loss) - Assets classified loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted.

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**4. LOANS AND ALLOWANCE FOR LOAN LOSSES:**

Loan grades are monitored regularly and updated as necessary based upon review of repayment status and consideration of periodic updates regarding the borrower's financial condition and capacity to meet contractual requirements. The following presents the Company's loans by risk rating based on the most recent information available as of December 31, 2012 and 2011:

	Construction and Development	Real Estate - Mortgage	Commercial Real Estate	Commercial and Industrial	Other	Total
<u>December 31, 2012</u>						
1-4 (Pass)	\$ 1,959,530	\$ 6,030,849	\$57,153,771	\$ 4,054,696	\$244,741	\$69,443,587
5 (Internal Watch List)	1,307,188	-	3,332,563	14,832	13,005	4,667,588
6 (Special Mention)	2,470,590	-	-	-	-	2,470,590
7 (Substandard)	2,910,000	-	542,000	49,520	-	3,501,520
8 (Doubtful)	-	-	-	-	-	-
9 (Loss)	-	-	-	-	-	-
Total	<u>\$ 8,647,308</u>	<u>\$ 6,030,849</u>	<u>\$61,028,334</u>	<u>\$ 4,119,048</u>	<u>\$257,746</u>	<u>\$80,083,285</u>
<u>December 31, 2011</u>						
1-4 (Pass)	\$ 5,437,275	\$ 7,676,754	\$49,305,957	\$ 7,243,622	\$335,130	\$69,998,738
5 (Internal Watch List)	3,818,081	-	-	38,697	181,719	4,038,497
6 (Special Mention)	-	-	847,366	-	-	847,366
7 (Substandard)	-	-	1,251,803	-	-	1,251,803
8 (Doubtful)	-	-	-	-	-	-
9 (Loss)	-	-	-	-	-	-
Total	<u>\$ 9,255,356</u>	<u>\$ 7,676,754</u>	<u>\$51,405,126</u>	<u>\$ 7,282,319</u>	<u>\$516,849</u>	<u>\$76,136,404</u>

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES:

In this current real estate environment it has become more common to restructure or modify the terms of certain loans under certain conditions (i.e. troubled debt restructures or “TDRs”). In those circumstances it may be beneficial to restructure the terms of a loan and work with the borrower for the benefit of both parties, versus forcing the property into foreclosure and having to dispose of it in an unfavorable real estate market. When we have modified the terms of a loan, we usually either reduce or defer payments for a period of time. We have not forgiven any material principal amounts on any loan modifications to date. TDRs as of December 31, 2012 and 2011 quantified by loan type classified separately as accrual and non-accrual are presented in the table below.

	Number of Loans	Accruing	Non-Accrual	Total
<u>December 31, 2012</u>				
Construction and development	-	\$ -	\$ -	\$ -
Real estate - mortgage	-	-	-	-
Commercial real estate	2	2,910,000	542,000	3,452,000
Commercial and industrial	-	-	-	-
Other	-	-	-	-
Total	<u>2</u>	<u>\$ 2,910,000</u>	<u>\$ 542,000</u>	<u>\$ 3,452,000</u>
<u>December 31, 2011</u>				
Construction and development	-	\$ -	\$ -	\$ -
Real estate - mortgage	-	-	-	-
Commercial real estate	1	-	166,842	166,842
Commercial and industrial	-	-	-	-
Other	-	-	-	-
Total	<u>1</u>	<u>\$ -</u>	<u>\$ 166,842</u>	<u>\$ 166,842</u>

Our policy is to return non accrual TDR loans to accrual status when all the principal and interest amounts contractually due, pursuant to its modified terms, are brought current and future payments are reasonably assured. Our policy also considers payment history of the borrower, but is not dependent upon a specific number of payments. The Company recorded no specific reserve as of December 31, 2012 and recognized partial charge offs of \$269,710 on the TDR loans described above during the year ended December 31, 2012. There were no specific reserves and no partial charge-off of TDRs for the year ended December 31, 2011.

Loans are modified to minimize loan losses when we believe the modification will improve the borrower’s financial condition and ability to repay the loan. We typically do not forgive principal. We generally either defer, or decrease monthly payments for a temporary period of time. A summary of the types of concessions made are presented in the table below.

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4. LOANS AND ALLOWANCE FOR LOAN LOSSES:

	Reduction of payment amount		Deferred payments for 90 days		Total	
	Number	Amount	Number	Amount	Number	Amount
<u>December 31, 2012</u>						
Commercial real estate	2	\$3,452,000	-	\$ -	2	\$ 3,452,000
<u>December 31, 2011</u>						
Commercial real estate	-	\$ -	1	\$ 166,842	1	\$ 166,842

The following table presents loans by portfolio segment modified as TDRs and the corresponding recorded investment, which includes accrued interest and fees, as of December 31, 2012 and 2011.

	2012		2011	
	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Construction and development	-	\$ -	-	\$ -
Real estate - mortgage	-	-	-	-
Commercial real estate	2	3,452,000	1	166,842
Commercial and industrial	-	-	-	-
Other	-	-	-	-
Total	<u>2</u>	<u>\$ 3,452,000</u>	<u>1</u>	<u>\$ 166,842</u>

There have been no loans modified as a TDR within the past twelve months for which there was a payment default within the twelve month period ended December 31, 2012.

During 2012, Company purchased loans with outstanding principal balances at the time of purchase of \$8,085,324, for a carrying value of \$8,428,950. No loans were purchased during the year ended December 31, 2011. The outstanding balances of these purchased loans as of December 31, 2012 was \$7,936,654, and these loans are included in the loan disclosures above.

During 2009, the Company purchased loans with outstanding principal balances at the time of purchase of \$20,229,202 for a carrying value of \$2,301,680. During the year ended December 31, 2011, the Company sold certain of these purchased loans with outstanding principal balances of \$2,266,064, resulting in a loss on sale of \$102,809. No loans were sold during the year ended December 31, 2012. As of December 31, 2012 and 2011, loans with outstanding principal balances of \$1,957,447 and \$1,957,447, respectively, remain with a carrying value of \$148,659 and \$248,659, respectively, are classified as loans held for sale. Of this carrying amount, \$148,658 and \$248,659 are classified as non-performing and impaired at December 31, 2012 and 2011. The non-performing loans have outstanding principal balances of \$1,957,447 and \$1,957,447 at December 31, 2012 and 2011. Management established a valuation allowance for these loans of \$100,000 as of December 31, 2012, and there was no valuation allowance as of December 31, 2011.

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5. PREMISES AND EQUIPMENT:

Major classifications of these assets at December 31, 2012 and 2011 are summarized as follows:

	<u>2012</u>	<u>2011</u>
Land	\$ 400,000	\$ 400,000
Building	1,247,583	1,247,583
Leasehold improvements	541,732	637,667
Furniture, fixtures and equipment	1,088,922	1,143,107
	<u>3,278,237</u>	<u>3,428,357</u>
Accumulated depreciation	(951,967)	(941,672)
Premises and equipment, net	<u>\$ 2,326,270</u>	<u>\$ 2,486,685</u>

Depreciation expense for the years ended December 31, 2012 and 2011 was \$272,462 and \$278,460, respectively.

6. DEPOSITS:

Deposit account balances at December 31, 2012 and 2011 are summarized as follows:

	<u>2012</u>	<u>2011</u>
Non-interest bearing demand deposits	\$ 9,040,274	\$ 9,119,354
Interest - bearing demand	37,800,117	40,864,017
Savings	182,857	103,158
Time, \$100,000 and over	23,438,543	30,345,023
Time, under \$100,000	10,348,109	13,885,079
Total Deposits	<u>\$ 80,809,900</u>	<u>\$ 94,316,631</u>

Time deposits listed above include \$4,030,299 and \$8,724,237 in brokered certificates of deposit at December 31, 2012 and 2011, respectively.

At December 31, 2012, the scheduled maturities of time deposits are as follows:

<u>Year Ending December 31,</u>	
2013	\$ 25,261,730
2014	5,165,571
2015	2,402,712
2016	354,327
2017	602,312
	<u>\$ 33,786,652</u>



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7. LEASES:

The Company entered into an agreement to lease a branch location in Duluth, Georgia for a term of sixty-seven months, with the lease commencing in January 2008. This lease contains a rental holiday for the first seven months of the lease and thereafter requires monthly rental payments. Current monthly rental payment is \$4,964.

The Company entered into an agreement to lease a branch location in Doraville, Georgia for a term of sixty months, with the lease commencing in October 2008. This lease contains a partial rental holiday for the first six months of the lease and thereafter requires monthly rental payments. Current monthly rental payment is \$10,965.

The minimum lease payments not including common area cost allocation under these leases are as follows:

Year Ending December 31,	Minimum Lease Payments
2013	\$ 133,422

Total rental expense for the years ended December 31, 2012 and 2011 was \$216,772 and \$216,210, respectively.

8. FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS:

Advances from the Federal Home Loan Bank (FHLB) as of December 31, 2012 and 2011 are summarized as follows:

December 31, 2012			
Rate Type	Maturity Date	Interest Rate	Amount
Fixed	03/18/13	3.15%	\$ 2,000,000
Convertible	09/04/18	3.60%	3,000,000
Convertible	09/10/18	3.25%	2,500,000
Fixed	12/27/13	0.60%	1,000,000
Principal Reducing Credit	03/20/17	1.05%	4,250,000
Fixed	06/24/13	0.27%	1,000,000
Fixed	09/27/13	0.30%	1,000,000
			\$ 14,750,000

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8. FEDERAL HOME LOAN BANK ADVANCES AND OTHER BORROWINGS:

December 31, 2011			
Rate Type	Maturity Date	Interest Rate	Amount
Fixed	03/18/13	3.15%	\$ 2,000,000
Convertible	09/04/18	3.60%	3,000,000
Convertible	09/10/18	3.25%	2,500,000
Fixed	03/26/12	0.27%	1,000,000
Fixed	06/25/12	0.34%	1,000,000
Fixed	12/24/12	0.50%	1,000,000
Fixed	12/27/13	0.60%	1,000,000
Fixed	12/27/12	0.33%	1,000,000
			\$ 12,500,000

The aggregate of the advances is collateralized by the Company's FHLB stock, the Company's deposits with the FHLB, securities and a blanket floating lien on a portion of the Company's loan portfolio, portions of which can be used to cover any defaults on repayments of advances. Total amount of loans pledged as of December 31, 2012 were approximately \$13,100,000.

As of December 31, 2012, the Company has lines of credit with four correspondent banks for overnight borrowings of \$25,900,000. The Company had no borrowings outstanding on these lines at December 31, 2011. The lines of credit and outstanding balances at December 31, 2012 were as follows:

<u>Correspondent Bank</u>	<u>Commitment</u>	<u>Balance Outstanding</u>
First National Bankers Bank	\$ 5,600,000	\$ -
Independent Bankers Bank	8,700,000	-
The Independent Bankers Bank	5,000,000	
CenterState Bank	6,600,000	3,019,000
	\$ 25,900,000	\$ 3,019,000

Individually the correspondent banks require the borrowings to be limited to a maximum of 10 to 14 consecutive days.

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9. INCOME TAXES:

The total provision for income taxes in the statement of operations is as follows:

	<u>2012</u>	<u>2011</u>
Currently payable	\$ -	\$ (685,111)
Deferred income taxes	71,274	739,485
Change in valuation allowance	<u>(4,087,039)</u>	<u>(54,374)</u>
	<u>\$ (4,015,765)</u>	<u>\$ -</u>

The Company's income tax expense differs from the amounts computed by applying the federal income tax statutory rates to income before income taxes. A reconciliation of the differences is as follows:

	<u>2012</u>	<u>2011</u>
Tax provision at statutory rate	\$ 118,593	\$ 23,106
Differences resulting from:		
State income taxes	(309,362)	3,118
Other items, net	262,043	28,150
Valuation allowance	<u>(4,087,039)</u>	<u>(54,374)</u>
Provision for income taxes	<u>\$ (4,015,765)</u>	<u>\$ -</u>

For the years ended December 31, 2012 and 2011, management believes there are no material amounts of uncertain tax positions. Additionally, there were no amounts of interest and penalties recognized in the balance sheet as of December 31, 2012 and 2011 or on the statements of income for the years ended December 31, 2012 and 2011. Further, all years subsequent to 2009 remain subject to examination.

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9. INCOME TAXES:

The following summarizes the components of deferred taxes at December 31, 2012 and 2011.

	<u>2012</u>	<u>2011</u>
Deferred income tax assets (liabilities)		
Allowance for loan losses	\$ 118,003	\$ 104,148
Pre-opening expense	347,991	382,055
Net operating loss carryforwards	2,756,664	3,192,354
Depreciation	(4,613)	(128,118)
Stock options	504,203	488,415
Deferred loan fees	46,063	46,063
Other	247,454	2,122
Securities available for sale	<u>(171,249)</u>	<u>(211,673)</u>
Total gross deferred income tax assets	3,844,516	3,875,366
Less valuation allowance	<u>-</u>	<u>(4,087,039)</u>
Total deferred tax assets (liabilities)	<u>\$ 3,844,516</u>	<u>\$ (211,673)</u>

The future tax consequences of the differences between the financial reporting and tax basis of the Company's assets and liabilities resulted in a net deferred tax asset. Management has performed an evaluation of future taxable income and determined that a valuation allowance is not necessary at December 31, 2012 as future taxable income is more likely than not to exceed the deferred tax asset.

The federal and state net operating loss carryforwards will expire beginning in 2027 if not previously utilized.

10. EARNINGS PER SHARE:

Weighted average common shares outstanding at December 31, 2012 and 2011 were 3,465,391. Weighted average common shares outstanding are used to calculate both basic and diluted earnings per share for the years ended December 31, 2012 and 2011 due to the antidilutive effect of potential common shares. The primary factor contributing to the antidilutive nature of potential common shares for the years ended December 31, 2012 and 2011 was that the weighted average exercise price exceeded the average market price for the year.

11. RELATED PARTY TRANSACTIONS:

The Company has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, principal officers, their immediate families, and affiliated companies in which they are principal stockholders (commonly referred to as related parties), 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 Company in the aggregate amount of \$1,341,114 and \$1,551,803 as of December 31, 2012 and 2011, respectively. Changes in related party loans for the year ended December 31, 2012 are as follows:

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11. RELATED PARTY TRANSACTIONS:

Balance, beginning of year	\$	1,551,803
Advances		-
Repayments		(210,689)
Balance, end of year	\$	1,341,114

These persons and firms had deposits with the Company totaling \$5,230,477 and \$5,102,469 at December 31, 2012 and 2011, respectively.

12. COMMITMENTS AND CONTINGENCIES:

The Company's nature of business is such that it ordinarily results in a certain amount of litigation. In the opinion of management, there is no litigation in which the outcome will have a material effect on the consolidated financial statements.

The Company does not anticipate any material losses as a result of the commitments and contingent liabilities.

13. FINANCIAL INSTRUMENTS:

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments can 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 amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company'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 written is represented by the contractual notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

	Contract Amount (In Thousands)	
	December 31, 2012	December 31, 2011
Commitments to extend credit	\$ 5,297	\$ 5,307
Standby letters of credit	\$ 844	\$ 1,094

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 Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit is based on management's credit evaluation of the counterparty.

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13. FINANCIAL INSTRUMENTS:

Standby letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan commitments to customers.

The Company has cash deposits with financial institutions in excess of the insured limitation of the Federal Deposit Insurance Corporation. If any of these financial institutions were not to honor its contractual liability, the Company could incur losses.

14. FAIR VALUE:

Financial Instruments Measured at Fair Value

The Company follows ASC 820, Fair Value Measurement and Disclosures. ASC 820 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC 820 applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements; accordingly, ASC 820 does not require any new fair value measurements of reported balances.

ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Fair value is used on a recurring basis for assets and liabilities in which fair value is the primary basis of accounting. Examples of these include available for sale and trading securities and loans held for sale. Additionally, fair value is used on a non-recurring basis to evaluate assets or liabilities for impairment or for disclosure purposes. Examples of these non-recurring uses of fair value include certain loans held for sale accounted for on a lower cost or market basis, foreclosed real estate, collateral dependent impaired loans and long-lived assets. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Depending on the nature of the asset or liability, the Company uses various valuation techniques and assumptions when estimating fair value, which are in accordance with ASC 820.

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

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14. FAIR VALUE:

Financial Instruments Measured at Fair Value

The table below presents the Company's assets measured at fair value on a recurring basis as of December 31, 2012 and 2011, aggregated by the level in the fair value hierarchy within which those measurements fall.

	December 31, 2012				Total Gains (Losses)
	Total	Level 1	Level 2	Level 3	
<u>Assets</u>					
Recurring fair value measurements:					
Securities available for sale:					
U.S. Government-sponsored enterprises (GSEs)	\$ 3,336,379	\$ -	\$ 3,336,379	\$ -	
State and municipal securities	5,614,424	-	5,614,424	-	
Mortgage-backed GSE residential	19,936,378	-	19,936,378	-	
Total securities available for sale	28,887,181	-	28,887,181	-	
Derivative instruments	5	-	-	5	
Loans held for sale	148,658	-	-	148,658	
Total recurring fair value measurements	<u>\$ 29,035,844</u>	<u>\$ -</u>	<u>\$ 28,887,181</u>	<u>\$ 148,663</u>	
Nonrecurring fair value measurements:					
Impaired loans	\$ 3,452,000	\$ -	\$ -	\$ 3,452,000	\$ (358,366)
Total nonrecurring fair value measurements	<u>\$ 3,452,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,452,000</u>	<u>\$ (358,366)</u>

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14. FAIR VALUE:

Financial Instruments Measured at Fair Value

	Total	Level 1	Level 2	Level 3	Total Gains (Losses)
<b>Assets</b>					
Recurring fair value measurements:					
Securities available for sale:					
U.S. Government-sponsored enterprises (GSEs)	\$ 2,012,163	\$ -	\$ 2,012,163	\$ -	
State and municipal securities	4,373,725	-	4,373,725	-	
Mortgage-backed GSE residential	29,748,757	-	29,748,757	-	
Total securities available for sale	36,134,645	-	36,134,645	-	
Derivative instruments	9,440	-	-	9,440	
Loans held for sale	248,658	-	-	248,658	
Total recurring fair value measurements	\$ 36,392,743	\$ -	\$ 36,134,645	\$ 258,098	
Nonrecurring fair value measurements:					
Impaired loans	\$ 1,251,803	\$ -	\$ -	\$ 1,251,803	\$ (503,833)
Foreclosed real estate	1,995,000	-	-	1,995,000	-
Total nonrecurring fair value measurements	\$ 3,246,803	\$ -	\$ -	\$ 3,246,803	\$ (503,833)

Securities classified as available-for-sale are reported at fair value utilizing Level 2 inputs. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. The investments in the Company's portfolio are generally not quoted on an exchange but are actively traded in the secondary institutional markets.

The derivative instrument held by the Company is reported at fair value utilizing Level 3 inputs. The valuation of this instrument is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual term of the derivative, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The fair values of interest rate options are determined using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates fell below (rise above) the strike rate of the floors (caps). The variable interest rates used in the calculation of projected receipts on the floor (cap) are based on an expectation of future interest rates derived from observable market interest rate curves and volatilities. To comply with the provisions of ASC 820, the Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees.



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14. FAIR VALUE:

Financial Instruments Measured at Fair Value

Loans held-for-sale are measured at the lower of cost or fair value. Fair value is currently based on the purchase price of the loan held for sale. Management believed that the overall value of these loans is based on the value of the collateral securing these loans. On loans held for sale, collateral includes commercial real estate.

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying balance sheet using significant unobservable (Level 3) inputs.

	Loans Held For Sale	Derivative Instruments
Balance, December 31, 2011	\$ 248,658	\$ 9,440
Valuation allowance for loan held for sale	(100,000)	-
Mark to market loss included in noninterest income	-	(9,435)
Balance, December 31, 2012	<u>\$ 148,658</u>	<u>\$ 5</u>

Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of cost or fair value. Fair value is measured based on the value of the collateral securing these loans and is classified at a Level 3 in the fair value hierarchy. Collateral may include real estate, or business assets including equipment, inventory and accounts receivable. The value of real estate collateral is determined based on an appraisal by qualified licensed appraisers hired by the Company. The value of business equipment is based on an appraisal by qualified licensed appraisers hired by the Company if significant, or the equipment's net book value on the business' financial statements. Inventory and accounts receivable collateral are valued based on independent field examiner review or aging reports. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business. Impaired loans are evaluated on at least a quarterly basis for additional impairment and adjusted accordingly.

Foreclosed real estate is adjusted to fair value upon transfer of the loans to foreclosed real estate. Subsequently, foreclosed real estate is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the collateral value. When the fair value of the collateral is based on an observable market price or a current appraised value, and therefore the foreclosed asset is recorded as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed real estate as nonrecurring Level 3.

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14. FAIR VALUE:

Fair Value of Financial Instruments

The following methods and assumptions that were used by the Company in estimating fair values of financial instruments are disclosed herein:

*Cash, federal funds sold, and interest bearing deposits with other banks.* The carrying amounts of cash and short-term instruments approximate their fair value due to the relatively short period to maturity of instruments.

*Investment securities.* Fair values for securities are based predominately on quoted market prices. If quoted market prices are not available, fair values are based on quoted market prices of similar instruments.

*Restricted stock.* The carrying values of restricted equity securities approximate fair values.

*Loans Held for Sale.* Loans held for sale are carried at the lower of cost or market value. Fair value is based on what secondary markets are offering for loans with similar characteristics.

*Loans receivable.* For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for fixed rate 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 impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

*Deposits.* The fair values disclosed for demand deposits are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate 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.

*Federal Home Loan Bank ("FHLB") advances and other borrowings.* Fair values of fixed rate FHLB advances and other borrowings are estimated using discounted cash flow analyses based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements. The carrying values of variable rate FHLB advances and other borrowings approximate fair value.

*Secured borrowings.* The carrying amounts of secured borrowings approximate their fair values.

*Accrued interest.* The carrying amounts of accrued interest approximate their fair values.

*Derivative instruments.* The fair values of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities.

*Off-balance-sheet instruments.* Fair values for off-balance-sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counter parties' credit standings.

**TOUCHMARK BANCSHARES, INC.  
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**Notes to Consolidated Financial Statements**

14. FAIR VALUE:

Fair Value of Financial Instruments

The Company's carrying amounts and estimated fair values of financial instruments as of December 31, 2012 and 2011 (in thousands) were as follows:

	2012		2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Assets:</b>				
Cash and due from banks	\$ 2,021	\$ 2,021	\$ 2,509	\$ 2,509
Federal funds sold	125	125	325	325
Interest-bearing accounts				
with other banks	4,342	4,342	6,730	6,730
Securities	28,887	28,887	36,135	36,135
Restricted stock	1,635	1,635	1,479	1,479
Loans held for sale	149	149	249	249
Loans receivable	78,193	78,586	74,269	75,602
Accrued interest receivable	429	429	434	434
Derivative instruments	-	-	9	9
<b>Liabilities</b>				
Deposits	80,810	80,972	94,317	94,571
Accrued interest payable	19	19	36	36
Federal funds purchased	3,019	3,019	-	-
FHLB advances	14,750	15,119	12,500	12,982

15. DERIVATIVE INSTRUMENT:

During 2009, the Company entered into an interest rate corridor transaction. An interest rate corridor is composed of a long interest rate cap position and a short interest rate cap position. The buyer of the corridor purchases a cap with a lower strike while selling a second cap with a higher strike. The premium earned on the second cap then reduces the cost of the structure as a whole. The buyer of the corridor is protected if rates rise above the first cap's strike (floor), but the benefit is limited to the level of the second cap's strike (ceiling).

This series of transactions consists of a purchased interest rate cap establishing a floor at 0.75% based on the 1 month LIBOR rate. Additionally, the Company sold an interest rate cap at 2.50% based on the 1 month LIBOR rate. Both transactions are forward start transactions with an effective date of July 1, 2010 and a termination date of July 1, 2013. The notional amount for each is \$10,000,000. The interest rate corridor transaction is considered a stand alone derivative instrument, and as such will be recorded in the financial statements at fair value, with changes in fair value included in net income (loss). Additionally, this transaction has a net settlement feature, and the effects of the net settlement will be included in interest income or expense as appropriate. The fair value as of December 31, 2012 and 2011 was \$5 and \$9,440, respectively, and is included in other assets.

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

16. EMPLOYEE BENEFITS:

The Company has a 401(k) plan covering all employees. Contributions under the 401(k) plan are made by the employee with the Company contributing 100% of the employee deferral up to 3% of the employee's salary and 50% of the deferral greater than 3% but less than 5% of the employee's salary during 2011. As of January 1, 2012, the Company no longer provided matching contribution. Expenses relating to this plan charged to operations amounted to \$35 and \$52,986 for 2012 and 2011, respectively.

17. STOCK BASED COMPENSATION:

Stock Options

During 2008, the Company adopted an Employee Incentive Stock Plan (the Stock Plan). The Stock Plan offers stock awards to key employees to encourage continued employment by facilitating their purchase of an equity interest in the Company. These awards are granted at the discretion of the Board of Directors at an exercise price determined by the Board at the grant date. Options awarded under the Stock Plan have a term of ten years from the date of grant and vest ratably over three years, unless otherwise stated in the award agreement. A total of 191,000 shares have been reserved under the Stock Plan.

The Company has 105,618 outstanding options to purchase common stock which were issued to employees of the Company and 10,000 options to purchase common stock were issued to a director. Upon issuance of options, compensation cost was recognized in the consolidated financial statements of the Company for all share-based payments granted, based on the grant date fair value estimated.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the assumptions listed in the table below. Expected volatility for the period has been determined by a combination of a calculated value based on expected volatility of similar entities, and on the historical volatility of the Company's stock. The expected term of options granted is based on the short-cut method and represents the period of time that the options granted are expected to be outstanding. Expected dividends are based on dividend trends and the market price of the Company's stock price at grant. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	December 31,	
	2012	2011
Risk-free interest rate	0.78 %	2.21 %
Expected life (years)	6.50	6.05
Expected volatility	56.10 %	56.10 %
Expected dividends	0.00 %	0.00 %
Expected forfeiture rate	27.75 %	27.49 %
Weighted average fair value of options granted	\$ 2.82	\$ 2.74
Weighted average exercise price	\$ 7.49	\$ 7.56

The Company recorded stock-based compensation expense related to the options of \$41,790 and \$97,502 during the years ended December 31, 2012 and 2011, respectively. At December 31, 2012, there was \$20,218 of unrecognized compensation cost related to options outstanding, which is expected to be recognized over a weighted-average period of 1.13 years.

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

17. STOCK BASED COMPENSATION:

Stock Options

A summary of activity in the Company's stock option plans is presented below:

	2012		2011	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	123,118	\$ 8.95	115,618	\$ 9.23
Granted	5,000	7.49	16,500	7.56
Exercised	-	-	-	-
Forfeited	(12,500)	10.00	(9,000)	10.00
Outstanding at end of year	115,618	\$ 8.77	123,118	\$ 8.95
Options exercisable at year-end	96,450	6.75	107,616	9.05

The outstanding options have a weighted average remaining contractual life of approximately 7.08 years as of December 31, 2012. The exercisable options have a weighted average remaining contractual life of approximately 7.62 years as of December 31, 2012. At December 31, 2012, the aggregate intrinsic value of options outstanding and exercisable was \$0.

Warrants

Type I (Director) warrants were awarded in recognition of certain directors contributions to the initial capitalization of the Company. The Company awarded only 30,000 Type I warrants due to the majority of warrants issued being Type II. These warrants vest over three years.

Type II (Organizer) warrants were awarded in recognition of the financial risk undertaken by organizers in contributing seed capital and guaranteeing certain liabilities of the Company to fund organizational expenses. Warrants were issued based on the amount of funds each organizer placed at risk, which included seed capital contributed and each organizers pro-rata share of an organizational line of credit and land loan guaranteed. The Company awarded 430,000 Type II warrants, which vested immediately upon issuance.

Type I and Type II warrants have an expiration term of 10 years from the anniversary date. The purchase price of each additional share under the warrant agreement is \$10 per share. Each warrant agreement has an anti-dilution clause whereby if the Company subdivides its outstanding shares of common stock into a greater number of shares, or declares and pays a stock dividend, the purchase price of each share shall be proportionately reduced, and the Company shall proportionately increase the number of shares of common stock.

Additionally, 12,500 immediately vesting warrants were issued to the organizational consultant during the first quarter of 2008. During the year ended December 31, 2010 3,333 stock warrants were forfeited. At December 31, 2012 and 2011, there were 469,167 stock warrants outstanding and 469,167 were fully vested.

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17. STOCK BASED COMPENSATION:

Warrants

The fair value of each warrant grant is estimated on the date of grant using the Black-Scholes option-pricing model with the assumptions listed in the table below. Expected volatility for the period has been determined by a combination of a calculated value based on expected volatility of similar entities, and on the historical volatility of the Company's stock. The expected term of warrants granted is based on the short-cut method and represents the period of time that the warrants granted are expected to be outstanding. Expected dividends are based on dividend trends and the market price of the Company's stock price at grant. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. There were no warrants granted or exercised for the years ended December 31, 2012 and 2011.

The Company recorded no stock-based compensation expense \$0 and \$35,600 for the years ended December 31, 2012 and 2011, respectively, related to these warrants.

At December 31, 2012, there was no unrecognized compensation cost related to warrants. The weighted average remaining contractual life of the warrants outstanding as of December 31, 2012 approximately 5.0 years. At December 31, 2012, the aggregate intrinsic value of warrants outstanding and exercisable was \$0.

18. REGULATORY MATTERS:

Touchmark National Bank is subject to various 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 Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital adequacy guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting principles. The Bank's capital classification is also subject to qualitative judgments by the regulators about components, risk weighting, 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 I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2012 that the Bank meets all capital adequacy requirements to which it is subject.

As of December 31, 2012, the most recent notification from the Office of Comptroller of the Currency categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank subsidiary must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the institution's category.

**TOUCHMARK BANCSHARES, INC.  
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**Notes to Consolidated Financial Statements**

**18. REGULATORY MATTERS:**

The Bank's actual capital amounts (in thousands) and ratios as of December 31, 2012 and 2011 are presented in the following table:

	Actual		For Capital Adequacy Purposes:		To Be Well Capitalized Under Prompt Corrective Action Provisions:	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	<u>As of December 31, 2012:</u>					
Total Capital (to Risk Weighted Assets)	\$ 24,274	25.2%	\$ 7,705	8.0%	\$ 9,631	10.0%
Tier I Capital (to Risk Weighted Assets)	\$ 23,063	24.0%	\$ 3,852	4.0%	\$ 5,778	6.0%
Tier I Capital (to Average Assets)	\$ 23,063	19.5%	\$ 4,729	4.0%	\$ 5,912	5.0%
<u>As of December 31, 2011:</u>						
Total Capital (to Risk Weighted Assets)	\$ 20,751	23.1%	\$ 7,199	8.0%	\$ 8,999	10.0%
Tier I Capital (to Risk Weighted Assets)	\$ 19,619	21.8%	\$ 3,600	4.0%	\$ 5,400	6.0%
Tier I Capital (to Average Assets)	\$ 19,619	15.3%	\$ 5,127	4.0%	\$ 6,408	5.0%

**19. LIMITATION ON DISTRIBUTIONS:**

Dividends paid by the Bank are the primary source of funds available to the Company. Banking regulations limit the amount of dividends that may be paid without prior approval of the regulatory authorities. These restrictions are based on the level of regulatory classified assets, the prior years' net earnings, and the ratio of equity capital to total assets. The Bank is currently not allowed to pay dividends to the Company until it becomes cumulatively profitable.

**20. OTHER OPERATING EXPENSES:**

Significant components of noninterest expenses are as follows:

	<u>2012</u>	<u>2011</u>
Foreclosed real estate costs	\$ 1,099,747	\$ 374,572
Data processing and information technology	409,077	414,967
Professional services	322,501	247,453
Loan collections	193,602	309,782
Supervisory assessments	192,733	290,703
Software license and fees	42,816	77,486

**TOUCHMARK BANCSHARES, INC.  
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**Notes to Consolidated Financial Statements**

21. CONDENSED FINANCIAL INFORMATION ON TOUCHMARK BANCSHARES, INC (PARENT COMPANY ONLY)

Condensed Balance Sheets

	December 31,	
	2012	2011
<u>ASSETS</u>		
Cash *	\$ 599,015	\$ 456,060
Interest-bearing deposits with other banks	245,000	490,000
Investment in subsidiary *	26,927,580	20,048,937
Loans held for sale, net of valuation allowance	148,658	248,658
Premises and equipment	-	1,572,383
Land held for sale	2,409,023	2,409,023
Other assets	275,800	-
Total assets	\$ 30,605,076	\$ 25,225,061
<u>LIABILITIES AND STOCKHOLDER'S EQUITY</u>		
Liabilities:		
Accounts payable	\$ 21,500	\$ -
Total liabilities	21,500	-
Stockholder's equity	30,583,576	25,225,061
Total liabilities and stockholder's equity	\$ 30,605,076	\$ 25,225,061

\* Eliminated in consolidation.



**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

21. CONDENSED FINANCIAL INFORMATION ON TOUCHMARK BANCSHARES, INC (PARENT COMPANY ONLY)

Condensed Statements of Operations

	<u>For the Year Ended December 31,</u>	
	<u>2012</u>	<u>2011</u>
Interest income:		
Investment income	\$ 2,958	\$ 9,889
Total interest income	<u>2,958</u>	<u>9,889</u>
Noninterest income:		
Gain on transfer of premises and equipment*	1,034,229	-
Rental income*	<u>28,466</u>	<u>170,796</u>
Total noninterest income	<u>1,062,695</u>	<u>170,796</u>
Noninterest expense:		
Occupancy and equipment	27,574	99,772
Loss on loans held for sale	-	102,809
Other operating expense	<u>234,007</u>	<u>144,392</u>
Total noninterest expense	<u>261,581</u>	<u>346,973</u>
Net income (loss) before equity in undistributed income of subsidiary	804,072	(166,288)
Equity in undistributed income of subsidiary	<u>4,318,925</u>	<u>234,248</u>
Income before taxes	5,122,997	67,960
Income tax benefit	<u>275,800</u>	<u>-</u>
Net income	<u>\$ 5,398,797</u>	<u>\$ 67,960</u>

\* Eliminated in consolidation.

**TOUCHMARK BANCSHARES, INC.  
AND SUBSIDIARY**

**Notes to Consolidated Financial Statements**

21. CONDENSED FINANCIAL INFORMATION ON TOUCHMARK BANCSHARES, INC (PARENT COMPANY ONLY)

Condensed Statements of Cash Flows

	<u>For the Year Ended December 31,</u>	
	<u>2012</u>	<u>2011</u>
Cash flow from operating activities:		
Net income	\$ 5,398,797	\$ 67,960
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	6,612	39,672
Net accretion	-	(473)
Valuation allowance for loans held for sale	100,000	-
Loss on sale of loans held for sale	-	102,809
Gain on transfer of premises and equipment	(1,034,229)	
Equity in undistributed income of subsidiary	(4,318,925)	(234,248)
Proceeds from sale of loans held for sale	-	167,528
Deferred tax assets	(199,928)	-
Decrease (increase) in other assets	(75,872)	584
Increase in other liabilities	21,500	-
Net cash provided (used) by operating activities	<u>(102,045)</u>	<u>143,832</u>
Cash flow from investing activities:		
Decrease (increase) in interest bearing accounts with other banks	245,000	(490,000)
Proceeds from call of securities available for sale	-	500,000
Net cash provided by investing activities	<u>245,000</u>	<u>10,000</u>
Net change in cash	142,955	153,832
Cash at the beginning of the year	<u>456,060</u>	<u>302,228</u>
Cash at the end of the year	<u>\$ 599,015</u>	<u>\$ 456,060</u>
Supplemental schedule of noncash investing and financing activities:		
Stock based compensation expensed at subsidiary	<u>\$ 41,790</u>	<u>\$ 97,502</u>
Fair value of premises and equipment transferred to subsidiary	<u>\$ 2,600,000</u>	<u>\$ -</u>

**TOUCHMARK BANCSHARES, INC.  
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**Notes to Consolidated Financial Statements**

20. SUBSEQUENT EVENTS:

The Company assessed events that have occurred subsequent to December 31, 2012 through March 12, 2013 for potential recognition and disclosure in the consolidated financial statements. During February of 2013, the Company obtained approval for and closed its Abbots Bridge branch, which resulted in a write-off of leasehold improvements. No other events have occurred that would require adjustment to or disclosure in the consolidated financial statements which were issued on March 12, 2013.



**TOUCHMARK**  
B A N C S H A R E S , I N C .

## **Board of Directors**

J.J. Shah, Chairman  
Bobby G. Williams, Vice Chairman  
Vivian A. Wong, Vice Chairman  
Pin Pin Chau  
William D. Crosby  
Howard R. Greenfield  
Yuling R. Hayter  
Sudhirkumar C. Patel  
Mukund C. Raja  
Hasmukh P. Rama  
Meena J. Shah

## **Executive Officers**

Pin Pin Chau  
President & CEO

Jorge L. Forment  
Chief Financial Officer

James E. LeBow  
Chief Credit Officer



**TOUCHMARK**  
B A N C S H A R E S , I N C .

3651 Old Milton Parkway  
Alpharetta, GA 30005  
770-407-6700

[www.touchmarknb.com](http://www.touchmarknb.com)