UNITED STATES SECURITIES AND EXCHANGE COMMISSION Washington, DC 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2011

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

Commission File Number 0-16761

HIGHLANDS BANKSHARES, INC.

(Exact name of registrant as specified in its charter)

West Virginia (State or other jurisdiction of incorporation or organization)

55-0650743 (I.R.S. Employer Identification No.)

> 26847 (Zip Code)

3 North Main Street P.O. Box 929 Petersburg, WV (Address of principal executive offices)

Registrant's telephone number, including area code: 304-257-4111

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$5 par value

Indicate by check mark if the registrant is a well-know seasoned issuer, as defined in Rule 405 or the Securities Act 🗆 Yes 🗵 No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act 🗆 Yes 🗵 No

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

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained in this form, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No D

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large Accelerated Filer Accelerated Filer Non-accelerated filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in rule 126-2 of the Act) Yes $\ \square$ No $\ \boxtimes$

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

The aggregate market value of the 1,231,452 shares of common stock of the registrant, issued and outstanding, held by non-affiliates on June 30, 2011, was approximately \$20,934,684 based on the closing sale price of \$17.00 per share on June 30, 2011. For the purposes of this calculation, the term "affiliate" refers to all directors and executive officers of the registrant.

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the last practicable date: As of March 30, 2012: 1,336,873 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates certain information by reference from the registrant's definitive proxy statement for the 2012 annual meeting of stockholders, which proxy statement will be filed on or about April 15, 2012, for the 2012 annual shareholders' meeting to be held May 8, 2012.

FORM 10-K INDEX

Part I		Page
Item 1.	Business	3
Item 1A.	Risk Factors	9
Item 1B.	Unresolved Staff Comments	9
Item 2.	Properties	9
Item 3.	Legal Proceedings	9
Item 4.	Mine Safety Disclosures	9
Part II		
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	9
Item 6.	Selected Financial Data	10
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	11
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	25
Item 8.	Financial Statements and Supplementary Data	26
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	67
Item 9A.	Controls and Procedures	67
Item 9B.	Other Information	67
Part III		
*Item 10.	Directors and Executive Officers and Corporate Governance	68
*Item 11.	Executive Compensation	68
*Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	68
*Item 13.	Certain Relationships, Related Transactions and Director Independence	68
*Item 14.	Principal Accounting Fees and Services	69
Part IV		
Item 15.	Exhibits and Financial Statement Schedules	69
Signatures		70

^{*} The information required by Items 10, 11, 12, 13 and 14, to the extent not included in this document, is incorporated herein by reference to the information included under the captions "Compliance with Section 16(a) of the Securities Exchange Act," "ELECTION OF DIRECTORS," "INFORMATION CONCERNING DIRECTORS AND NOMINEES," "REPORT OF THE AUDIT COMMITTEE," "EXECUTIVE COMPENSATION," "SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT" and "CERTAIN RELATED TRANSACTIONS" in the registrant's definitive proxy statement which is expected to be filed on or about April 15, 2012, for the 2012 annual shareholders' meeting to be held May 8, 2012.

PART I

Item 1. Business

General

Highlands Bankshares, Inc. (hereinafter referred to as "Highlands," or the "Company"), incorporated under the laws of the State of West Virginia in 1985, is a multi bank holding company subject to the provisions of the Bank Holding Company Act of 1956, as amended. Highlands owns 100% of the outstanding stock of its subsidiary banks, The Grant County Bank and Capon Valley Bank (hereinafter referred to as the "Banks" or "Capon" and/or "Grant"), and its life insurance subsidiary, HBI Life Insurance Company (hereinafter referred to as "HBI Life").

The Grant County Bank was chartered on August 6, 1902, and Capon Valley Bank was chartered on July 1, 1918. Both are state banks chartered under the laws of the State of West Virginia. HBI Life was chartered in April 1988 under the laws of the State of Arizona.

Services Offered by the Banks

The Banks offer all services normally offered by a full service commercial bank, including commercial and individual demand and time deposit accounts, commercial and individual loans, drive in banking services, internet banking services, and automated teller machines. No material portion of the Banks' deposits have been obtained from a single or small group of customers and the loss of the deposits of any one customer or of a small group of customers would not have a material adverse effect on the business of the Banks. Credit life and accident and health insurance are sold to customers of the subsidiary Banks through HBI Life.

Employees

As of December 31, 2011, The Grant County Bank had 73 full time equivalent employees, Capon Valley Bank had 48 full time equivalent employees and Highlands had four full time equivalent employees. No person is employed by HBI Life on a full time basis.

Competition

The Banks' primary trade area is generally defined as Grant, Hardy, Mineral, Randolph, Pendleton and Tucker Counties in West Virginia, portions of Frederick County in Virginia and portions of Western Maryland. This area includes the towns of Petersburg, Wardensville, Moorefield and Keyser in West Virginia, the town of Stephen City in Virginia, and several smaller rural communities mainly in West Virginia. The Banks' secondary trade area includes portions of Hampshire County in West Virginia. The Banks primarily compete with four state chartered banks, three national banks, and three credit unions. In addition, the Banks compete with money market mutual funds and investment brokerage firms for deposits in their service area. No financial institution has been chartered in the area within the last five years although other state and nationally chartered banks have opened branches in this area within this time period. Competition for new loans and deposits in the Banks' service area is quite intense.

Regulation and Supervision

The Company, as a registered bank holding company, and its subsidiary Banks, as insured depository institutions, operate in a highly regulated environment and are regularly examined by federal and state regulators. The following description briefly discusses certain provisions of federal and state laws and regulations and the potential impact of such provisions to which the Company and subsidiary are subject. These federal and state laws and regulations are designed to reduce potential loss exposure to the depositors of such depository institutions and to the Federal Deposit Insurance Corporation's insurance fund and are not intended to protect the Company's security holders. Proposals to change the laws and regulations governing the banking industry are frequently raised in Congress, in state legislatures, and before the various bank regulatory agencies. The likelihood and timing of any changes and the impact such changes might have on the Company are impossible to determine with any certainty. A change in applicable laws or regulations, or a change in the way such laws or regulations are interpreted by regulatory agencies or courts, may have a material impact on the business, operations and earnings of the Company. To the extent that the following information describes statutory or regulatory provisions, it is qualified entirely by reference to the particular statutory or regulatory provision.

As a bank holding company registered under the Bank Holding Company Act of 1956, as amended (the "BHCA"), the Company is subject to regulation by the Federal Reserve Board. Federal banking laws require a bank holding company to serve as a source of financial strength to its subsidiary depository institutions and to commit resources to support such institutions in circumstances where it might not do so otherwise. Additionally, the Federal Reserve Board has jurisdiction under the BHCA to approve any bank or non-bank acquisition, merger or consolidation proposed by a bank holding company. The BHCA generally limits the activities of a bank holding company and its subsidiaries to that of banking, with the managing or controlling of banks as to be a proper incident thereto. The BHCA also prohibits a bank holding company, with certain exceptions, from acquiring more than 5% of the voting shares of any company and from engaging in any business other than banking or managing or controlling banks. The Federal Reserve Board has determined by regulation that certain activities are closely related to banking within the meaning of the BHCA. These activities include: operating a mortgage company, finance company, credit card company or factoring company; performing certain data processing operations; providing investment and financial advice; and acting as an insurance agent for certain types of credit-related insurance.

The Gramm-Leach-Bliley Act ("Gramm-Leach") became law in November 1999. Gramm-Leach established a comprehensive framework to permit affiliations among commercial banks, investment banks, insurance companies, securities firms, and other financial service providers. Gramm-Leach permits qualifying bank holding companies to register with the Federal Reserve Board as "financial holding companies" and allows such companies to engage in a significantly broader range of financial activities than were historically permissible for bank holding companies. Although the Federal Reserve Board provides the principal regulatory supervision of financial services permitted under Gramm-Leach, the Securities and Exchange Commission and state regulators also provide substantial supervisory oversight. In addition to broadening the range of financial services a bank holding company may provide, Gramm-Leach also addressed customer privacy and information sharing issues and set forth certain customer disclosure requirements. The Company has no current plans to petition the Federal Reserve Board for consideration as a financial holding company.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle-Neal") permits bank holding companies to acquire banks located in any state. Riegle-Neal also allows national banks and state banks with different home states to merge across state lines and allows branch banking across state lines, unless specifically prohibited by state laws.

The International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 ("Patriot Act") was adopted in response to the September 11, 2001 terrorist attacks. The Patriot Act provides law enforcement with greater powers to investigate terrorism and prevent future terrorist acts. Among the broad-reaching provisions contained in the Patriot Act are several designed to deter terrorists' ability to launder money in the United States and provide law enforcement with additional powers to investigate how terrorists and terrorist organizations are financed. The Patriot Act creates additional requirements for banks, which were already subject to similar regulations. The Patriot Act authorizes the Secretary of Treasury to require financial institutions to take certain "special measures" when the Secretary suspects that certain transactions or accounts are related to money laundering. These special measures may be ordered when the Secretary suspects that a jurisdiction outside of the United States, a financial institution operating outside of the United States, a class of transactions involving a jurisdiction outside of the United States or certain types of accounts are of "primary money laundering concern." The special measures include the following: (a) require financial institutions to keep records and report on transactions or accounts at issue; (b) require financial institutions to obtain and retain information related to the beneficial ownership of any account opened or maintained by foreign persons; (c) require financial institutions to identify each customer who is permitted to use the account; and (d) prohibit or impose conditions on the opening or maintaining of correspondence or payable-through accounts. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing or to comply with all of the relevant laws or regulations could have serious legal and reputational consequences for an institution.

The operations of the insurance subsidiary are subject to the oversight and review by the State of Arizona Department of Insurance.

On July 30, 2002, the United States Congress enacted the Sarbanes-Oxley Act of 2002, a law that addresses corporate governance, auditing and accounting, executive compensation and enhanced timely disclosure of corporate information. As Sarbanes-Oxley directs, the Company's Chief Executive Officer and Chief Financial Officer are each required to certify that the Company's quarterly and annual reports do not contain any untrue statement of a material fact. Additionally, these individuals must certify the following: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the Company's internal controls; they have made certain disclosures to the Company's auditors and the Audit Committee of the Board of Directors about the Company's internal controls; and they have included information in the Company's quarterly and annual reports about their evaluation and whether there have been significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the evaluations.

Capital Adequacy

Federal banking regulations set forth capital adequacy guidelines, which are used by regulatory authorities to assess the adequacy of capital in examining and supervising a bank holding company and its insured depository institutions. The capital adequacy guidelines generally require bank holding companies to maintain total capital equal to at least 8% of total risk-adjusted assets, with at least one-half of total capital consisting of core capital (i.e., Tier II capital), such as perpetual preferred stock, certain subordinated debt, and, subject to limitations, the allowance for loan losses. Tier I capital generally includes common stockholders' equity plus, within certain limitations, perpetual preferred stock and trust preferred securities. For purposes of computing risk-based capital ratios, bank holding companies must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance sheet items, calculated under regulatory accounting practices. The Company's and its subsidiaries' capital accounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

In addition to total and Tier I capital requirements, regulatory authorities also require bank holding companies and insured depository institutions to maintain a minimum leverage capital ratio of 3%. The leverage ratio is determined as the ratio of Tier I capital to total average assets, where average assets exclude goodwill, other intangibles, and other specifically excluded assets. Regulatory authorities have stated that minimum capital ratios are adequate for those institutions that are operationally and financially sound, experiencing solid earnings, have high levels of asset quality and are not experiencing significant growth. The guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels. In those instances where these criteria are not evident, regulatory authorities expect, and may require, bank holding companies and insured depository institutions to maintain higher than minimum capital levels.

Additionally, federal banking laws require regulatory authorities to take "prompt corrective action" with respect to depository institutions that do not satisfy minimum capital requirements. The extent of these powers depends upon whether the institutions in question are "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized," as such terms are defined under uniform regulations defining such capital levels issued by each of the federal banking agencies. As an example, a depository institution that is not well capitalized is generally prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market. Additionally, a depository institution is generally prohibited from making any capital distribution (including payment of a dividend) or paying any management fee to its holding company, may be subject to asset growth limitations and may be required to submit capital restoration plans if the depository institution is considered undercapitalized.

The Company's and its subsidiaries' regulatory capital ratios are presented in the table below:

	Actual Ratio December 31, 2011	Actual Ratio December 31, 2010	Regulatory Minimum
Total Risk Based Capital			
Highlands Bankshares	15.17%	14.49%	8.00%
The Grant County Bank	15.31%	14.58%	8.00%
Capon Valley Bank	13.16%	12.50%	8.00%
Tier 1 Leverage Ratio			
Highlands Bankshares	10.22%	9.91%	4.00%
The Grant County Bank	10.55%	10.26%	4.00%
Capon Valley Bank	8.50%	8.33%	4.00%
Tier 1 Risk Based Capital Ratio			
Highlands Bankshares	13.91%	13.24%	4.00%
The Grant County Bank	14.06%	13.32%	4.00%
Capon Valley Bank	11.90%	11.24%	4.00%
•			

Dividends and Other Payments

The Company is a legal entity separate and distinct from its subsidiaries. Dividends and management fees from Grant County Bank and Capon Valley Bank are essentially the sole source of cash for the Company, although HBI Life will periodically pay dividends to the Company. The right of the Company, and shareholders of the Company, to participate in any distribution of the assets or earnings of Grant County Bank and Capon Valley Bank through the payment of such dividends or otherwise is necessarily subject to the prior claims of creditors of Grant County Bank and Capon Valley Bank, except to the extent that claims of the Company in its capacity as a creditor may be recognized. Moreover, there are various legal limitations applicable to the payment of dividends to the Company as well as the payment of dividends by the Company to its shareholders. Under federal law, Grant County Bank and Capon Valley Bank may not, subject to certain limited exceptions, make loans or extensions of credit to, or invest in the securities of, take securities of the Company as collateral for loans to any borrower. Grant County Bank and Capon Valley Bank are also subject to collateral security requirements for any loans or extensions of credit permitted by such exceptions.

Grant County Bank and Capon Valley Bank are subject to various statutory restrictions on their ability to pay dividends to the Company. Specifically, the approval of the appropriate regulatory authorities is required prior to the payment of dividends by Grant County Bank and Capon Valley Bank in excess of earnings retained in the current year plus retained net profits for the preceding two years. The payment of dividends by the Company, Grant County Bank and Capon Valley Bank may also be limited by other factors, such as requirements to maintain adequate capital above regulatory guidelines. The Federal Reserve Board and the Federal Deposit Insurance Corporation have the authority to prohibit any bank under their jurisdiction from engaging in an unsafe and unsound practice in conducting its business. Depending upon the financial condition of Grant County Bank and Capon Valley Bank, the payment of dividends could be deemed to constitute such an unsafe or unsound practice. The Federal Reserve Board and the FDIC have indicated their view that it's generally unsafe and unsound practice to pay dividends except out of current operating earnings. The Federal Reserve Board has stated that, as a matter of prudent banking, a bank or bank holding company should not maintain its existing rate of cash dividends on common stock unless (1) the organization's net income available to common shareholders over the past year has been sufficient to fund fully the dividends and (2) the prospective rate or earnings retention appears consistent with the organization's capital needs, asset quality, and overall financial condition. Moreover, the Federal Reserve Board has indicated that bank holding company should not maintain a level of cash dividends to its shareholders that places undue pressure on the capital of bank subsidiaries, or that can be funded only through additional borrowings or other arrangements that may undermine the bank holding company's ability to serve as a source of strength.

Governmental Policies

The Federal Reserve Board regulates money and credit and interest rates in order to influence general economic conditions. These policies have a significant influence on overall growth and distribution of bank loans, investments and deposits and affect interest rates charged on loans or paid for time and savings deposits. Federal Reserve monetary policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future.

Various other legislation, including proposals to overhaul the banking regulatory system and to limit the investments that a depository institution may make with insured funds, are from time to time introduced in Congress. The Company cannot determine the ultimate effect that such potential legislation, if enacted, would have upon its financial condition or operations.

Beginning in late 2008, the economic environment caused higher levels of bank failures, which dramatically increased FDIC resolution costs and led to a significant reduction in the Deposit Insurance Fund. As a result, the FDIC has significantly increased the initial base assessment rates paid by financial institutions for deposit insurance. The base assessment rate was increased by seven basis points (7 cents for every \$100 of deposits) for the first quarter of 2009. Effective April 1, 2009, initial base assessment rates were changed to range from 12 basis points to 45 basis points across all risk categories with possible adjustments to these rates based on certain debt-related components. These increases in the base assessment rate have increased our deposit insurance costs and negatively impacted our earnings. In addition, in May 2009, the FDIC imposed a special assessment on all insured institutions due to recent bank and savings association failures. The emergency assessment amounted to five basis points on each institution's assets minus tier one (core) capital as of June 30, 2009, subject to a maximum equal to 10 basis points times the institution's assessment base. The Company's special assessment, which was reflected in earnings for the quarter ended June 30, 2009, was approximately \$179,000. The FDIC may impose additional emergency special assessments if necessary to maintain public confidence in federal deposit insurance or as a result of deterioration in the deposit insurance fund reserve ratio due to institution failures. Any additional emergency special assessment imposed by the FDIC will negatively impact our earnings.

On November 12, 2009, the FDIC adopted a final rule requiring that all institutions prepay their assessments for the fourth quarter of 2009 and all of 2010, 2011 and 2012. This pre-payment was due on December 30, 2009. However, the FDIC may exempt certain institutions from the prepayment requirement if the FDIC determines that the prepayment would adversely affect the safety and soundness of the institution.

In April 2011, the FDIC implemented rulemaking under the Dodd-Frank Act to reform the deposit insurance assessment system. The final rule redefined the assessment base used for calculating deposit insurance assessments. Specifically, the rule bases assessments on an institution's total assets less tangible capital, as opposed to total deposits. Since the new base is larger than the prior base, the FDIC also lowered the assessment rates so that the rules would not significantly alter the total amount of revenue collected from the industry. The new assessment scale ranges from 2.5 basis points for the least risky institutions to 45 basis points for the riskiest. Either an increase in the Risk Category or adjustments to the base assessment rates could have a material adverse effect on our earnings.

The Company is subject to extensive regulation, supervision and examination by federal and state banking authorities. Any change in applicable regulations or laws could have a substantial impact on the Company's operations. Additional legislation and regulations that could significantly affect the Company's powers, authority and operations may be enacted or adopted in the future, which could have a material adverse effect on the Company's financial condition and results of operations. New legislation proposed by Congress may give bankruptcy courts the power to reduce the increasing number of home foreclosures by giving bankruptcy judges the authority to restructure mortgages and reduce a borrower's payments. Property owners would be allowed to keep their property while working out their debts. Other similar bills placing additional temporary moratoriums on foreclosure sales or otherwise modifying foreclosure procedures to the benefit of borrowers and the detriment of lenders may be enacted by either Congress or the States of West Virginia, Pennsylvania or Maryland in the future. These laws may further restrict the Company's collection efforts on one-to-four single-family mortgage loans. Additional legislation proposed or under consideration in Congress would give current debit and credit card holders the chance to opt out of an overdraft protection program and limit overdraft fees, which could result in additional operational costs and a reduction in the Company's non-interest income

Further, the Company's regulators have significant discretion and authority to prevent or remedy unsafe or unsound practices or violations of laws by financial institutions and holding companies in the performance of their supervisory and enforcement duties. In this regard, banking regulators are considering additional regulations governing compensation, which may adversely affect the Company's ability to attract and retain employees.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). The Act has resulted in financial regulatory reform aimed at strengthening the nation's financial services sector. The Act's provisions and rules promulgated there under that have received the most public attention generally have been those applying to larger institutions or institutions or institutions that engage in practices in which we do not engage. These provisions include growth restrictions, credit exposure limits, higher prudential standards, prohibitions on proprietary trading, and prohibitions on sponsoring and investing in hedge funds and private equity funds. However, the Act contains numerous other provisions that likely will directly impact us and our banking subsidiaries. These include increased fees payable by banks to regulatory agencies, new capital guidelines for banks and bank holding companies, permanently increasing the FDIC insurance coverage from \$100,000 to \$250,000 per depositor, new liquidation procedures for banks, new regulations affecting consumer financial products, new corporate governance disclosures and requirements, and the increased cost of supervision and compliance more generally. Many aspects of the law continue to be subject to rulemaking by various government agencies and will take effect over several years. This time table, combined with the Act's significant deference to future rulemaking by various regulatory agencies, makes it difficult for us to anticipate the Act's overall financial, competitive and regulatory impact on us, our customers, and the financial industry more generally.

Available Information

The Company files annual, quarterly and current reports, proxy statements and other information with the SEC. The Company's SEC filings are filed electronically and are available to the public via the Internet at the SEC's website, www.sec.gov. In addition, any document filed by the Company with the SEC can be read and copies obtained at the SEC's public reference facilities at 100 F Street, NE, Washington, DC 20549. Copies of documents can be obtained at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Copies of documents can also be obtained free of charge by writing to Highlands Bankshares, Inc., P.O. Box 929, Petersburg, WV 26847.

Executive Officers

C.E. Porter	<u>Age</u> 63	Position with the Company Chief Executive Officer	Principal Occupation (Past Five Years) CEO of Highlands since 2004, President of The Grant County Bank 1991 through 2010
Alan L. Brill	57	Secretary and Treasurer; President of Capon Valley Bank	President of Capon Valley Bank since 2001
Jeffrey B. Reedy	49	Chief Financial Officer	CFO of Highlands since March 2010, Prior to Highlands, Corporate Controller for American Woodmark Corporation.
			8

Item 1A. Risk Factors

Not required for smaller reporting companies.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The table below lists the primary properties utilized in operations by the Company. All listed properties are owned by the Company.

<u>Location</u>	Description
3 N. Main Street, Petersburg, WV 26847	Primary Office, The Grant County Bank
Route 33, Riverton, WV 26814	Branch Office, The Grant County Bank
500 S. Main Street, Moorefield, WV 26836	Branch Office, The Grant County Bank
Route 220 & Josie Dr., Keyser, WV 26726	Branch Office, The Grant County Bank
Main Street, Harman, WV 26270	Branch Office, The Grant County Bank
William Avenue, Davis, WV 26260	Branch Office, The Grant County Bank
5502 Appalachian Hwy., Davis, WV 26260	Branch Office, The Grant County Bank
2 W. Main Street, Wardensville, WV 26851	Primary Office, Capon Valley Bank
717 N. Main Street, Moorefield, WV 26836	Branch Office, Capon Valley Bank
17558 SR55, Baker, WV 26801	Branch Office, Capon Valley Bank
6701 Northwestern Pike, Gore, VA 22637	Branch Office, Capon Valley Bank
5511 Main Street, Stephens City, VA 22655	Branch Office, Capon Valley Bank

Item 3. Legal Proceedings

Management is not aware of any material pending or threatened litigation in which Highlands or its subsidiaries may be involved as a defendant. In the normal course of business, the Banks periodically must initiate suits against borrowers as a final course of action in collecting past due indebtedness.

Item 4. Mine Safety Disclosures – Not Applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company had approximately 825 shareholders as of December 31, 2011. This amount includes all shareholders, whether titled individually or held by a brokerage firm or custodian in street name. The Company's stock is not traded on any national or regional stock exchange although brokers may occasionally initiate or be a participant in a trade. The Company's stock is listed on the Over the Counter Bulletin Board under the symbol HBSI.OB. The Company may not know terms of an exchange between individual parties.

The table on the following page outlines the dividends paid and market prices of the Company's stock based on prices disclosed to management. Prices have been provided using a nationally recognized online stock quote system. Such prices may not include retail mark-ups, mark-downs, or commissions. Dividends are subject to the restrictions described in Note Nine to the Financial Statements.

Highlands Bankshares, Inc. Common Stock

		Dividends Per Share			ted Market Range	ket Range Low		
<u>2011</u>	_		' <u></u>					
First Quarter	\$	0.25	\$	19.35	\$	18.20		
Second Quarter	\$	0.20	\$	18.75	\$	16.80		
Third Quarter	\$	0.00	\$	17.25	\$	14.45		
Fourth Quarter	\$	0.00	\$	15.00	\$	13.80		
<u>2010</u>								
First Quarter	\$	0.27	\$	25.75	\$	20.55		
Second Quarter	\$	0.27	\$	29.75	\$	20.00		
Third Quarter	\$	0.25	\$	24.00	\$	18.50		
Fourth Quarter	\$	0.25	\$	24.00	\$	18.10		

Item 6. Selected Financial Data

The following table is not required for smaller reporting companies; however, the Company believes this information may be important to the reader.

	Years Ending December 31, (In thousands of dollars, except for per share amounts)							2007		
m . I v v		2011		2010		2009	_	2008	_	2007
Total Interest Income	\$	21,130	\$	22,897	\$	24,274	\$	26,203	\$	27,664
Total Interest Expense		4,583		6,214		7,841		8,866		10,703
Net Interest Income		16,547		16,683		16,433		17,337		16,961
Provision for Loan Losses		3,624		3,487		1,864		909		837
Net Interest Income After Provision for Loan Losses		12,923		13,196		14,569		16,428		16,124
Other Income		2,152		2,145		2,532		2,699		2,080
Other Expenses	_	13,145	_	13,109		12,053	_	11,419	_	10,952
Income Before Income Taxes		1,930		2,232		5,048		7,708		7,252
Income Tax Expense	_	538		640		1,692	_	2,738		2,599
Net Income	\$	1,392	\$	1,592	\$	3,356	\$	4,970	\$	4,653
Total Assets at Year End	\$	404,194	\$	399,900	\$	407,810	\$	378,295	\$	380,936
Long Term Debt at Year End	\$	11,245	\$	9,393	\$	10,866	\$	11,317	\$	11,819
Net Income Per Share of Common Stock	\$	1.04	\$	1.19	\$	2.51	\$	3.59	\$	3.24
Dividends Per Share of Common Stock	\$	0.45	\$	1.04	\$	1.16	\$	1.08	\$	1.00
Return on Average Assets		0.34%		0.38%		0.84%		1.32%		1.24%
Return on Average Equity		3.41%		4.00%		8.33%		12.38%		12.03%
Dividend Payout Ratio		43.25%		87.39%		46.19%		30.12%		30.88%
Year End Equity to Assets Ratio		10.31%		10.34%		10.16%		10.41%		10.66%

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

Forward Looking Statements

Certain statements in this report may constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that include projections, predictions, expectations or beliefs about future events or results or otherwise are not statements of historical fact. Such statements are often characterized by the use of qualified words (and their derivatives) such as "expect," "believe," "estimate," "plan," "project," "anticipate" or other similar words. Although the Company believes that its expectations with respect to certain forward-looking statements are based upon reasonable assumptions within the bounds of its existing knowledge of its business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Actual future results and trends may differ materially from historical results or those anticipated depending on a variety of factors, including, but not limited to, the effects of and changes in: general economic conditions, the interest rate environment, legislative and regulatory requirements, competitive pressures, new products and delivery systems, inflation, changes in the stock and bond markets, technology, downturns in the trucking, mining, and timber industries, downturns in the housing market affecting manufacturers of household cabinetry and thus, employment, effects of mergers and/or downsizing in the poultry industry in Hardy County, continued challenges in the current economic environment affecting our financial condition and results of operations, continued deterioration in the financial condition of the U.S. banking system impacting the valuations of investments the Company has made in the securities of other financial institutions, and consumer spending and savings habits, particularly in the current economic environment. Additionally, actual future results and trends may differ from historical or anticipated results to the extent: (1) any significant downturn in certain industries, particularly the trucking and timber industries are experienced; (2) loan demand decreases from prior periods; (3) the Company may make additional loan loss provisions due to negative credit quality trends in the future that may lead to a deterioration of asset quality; (4) the Company may not continue to experience significant recoveries of previously charged-off loans or loans resulting in foreclosure; (5) the Company is unable to control costs and expenses as anticipated, (6) legislative and regulatory changes could increase expenses (including changes as a result of rules and regulations adopted under the Dodd-Frank Wall Street Reform and Consumer Protection Act); (7) the effects of the last year's down grade of U.S. Government Securities by one of the credit rating agencies could have a material adverse effect on the company's operations, earnings and financial condition; and (8) any additional assessments imposed by the FDIC. Additionally, consideration should be given to the cautionary language contained elsewhere in this Form 10-K. The Company does not update any forward-looking statements that may be made from time to time by or on behalf of the Company.

Introduction

The following discussion focuses on significant results of the Company's operations and significant changes in our financial condition or results of operations for the periods indicated in the discussion. This discussion should be read in conjunction with the financial statements and related notes included in this report. Current performance does not guarantee, and may not be indicative of, similar performance in the future.

Critical Accounting Policies

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

Allowance for Loan Losses

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

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are determined to be impaired. The general component covers non-impaired loans and is based on management's internal risk ratings as well as historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses.

GAAP does not specify how an institution should identify loans that are to be evaluated for collectability, nor does it specify how an institution should determine that a loan is impaired. Each subsidiary of Highlands uses its standard loan review procedures in making those judgments so that allowance estimates are based on a comprehensive analysis of the loan portfolio. For loans that are individually evaluated and found to be impaired, the associated allowance is based upon the estimated fair value, less costs to sell, of any collateral securing the loan as compared to the existing balance of the loan as of the date of analysis.

All other loans, including individually evaluated loans determined not to be impaired, are included in a group of loans that are measured under ASC 450 to provide for estimated credit losses that have been incurred on groups of loans with similar risk characteristics. The methodology for measuring estimated credit losses on groups of loans with similar risk characteristics in accordance with ASC 450 is based on each group's historical net charge-off rate, adjusted for the effects of the qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the group's historical loss experience.

Post Retirement Benefits and Life Insurance Investments

The Company has invested in and owns life insurance policies on key officers. The policies are designed so that the company recovers the interest expenses associated with carrying the policies and the officer will, at the time of retirement, receive any earnings in excess of the amounts earned by the Company. The Company recognizes as an asset the net amount that could be realized under the insurance contract as of the balance sheet date. This amount represents the cash surrender value of the policies less applicable surrender charges. The portion of the benefits, which will be received by the executives at the time of their retirement, is considered, when taken collectively, to constitute a retirement plan. Therefore the Company accounts for these policies using guidance found in ASC 715, Compensation –Retirement Benefits. ASC 715 requires that an employer's obligation under a deferred compensation agreement be accrued over the expected service life of the employee through their normal retirement date. Assumptions are used in estimating the present value of amounts due officers after their normal retirement date. These assumptions include the estimated income to be derived from the investments and an estimate of the Company's cost of funds in these future periods. In addition, the discount rate used in the present value calculation will change in future years based on market conditions.

Intangible Assets

The Company carries intangible assets related to the purchase of two banks. Amounts paid to purchase these banks were allocated as intangible assets. Generally accepted accounting principles were applied to allocate the intangible components of the purchases. The excess was allocated between identifiable intangibles (core deposit intangibles) and unidentified intangibles (goodwill). Goodwill is required to be evaluated for impairment on an annual basis, and the value of the goodwill adjusted accordingly, should impairment be found. As of December 31, 2011, the Company did not identify an impairment of this intangible. In addition to the intangible assets associated with the purchases of banks, the company also carries intangible assets relating to the purchase of naming rights to certain features of a performing arts center in Petersburg, WV. Intangible assets other than goodwill, which are determined to have finite lives, are amortized based upon the estimated economic benefits received.

A summary of the change in balances of intangible assets can be found in Note Twenty One to the Financial Statements.

Recent Accounting Pronouncements

Refer to Note Two of the Company's consolidated financial statements for a discussion of recent accounting pronouncements.

Overview of 2011 Results

Net income for 2011 decreased by 12.56% as compared to 2010. The Company's net interest income decreased slightly as the reduction in interest expenses matched the decreases in interest income. The Company experienced an increase in the provision for loan losses of 3.93% or \$137,000 from 2010 to 2011. Non-interest income increased 0.33%. The increase in non-interest income was the result of increase in life insurance investment income in excess of the decreases in overdraft fees, service charge fees, and non-recurring gains on the sale of securities during 2010. Non-interest expense increased 0.27% due largely to decreases in employee related costs and decreased FDIC insurance premium rates offset by impairment write-downs of other real estate owned.

The table below compares selected commonly used measures of bank performance for the twelve month periods ended December 31, 2011 and 2010:

	2011	2010
Annualized return on average assets	0.34%	0.38%
Annualized return on average equity	3.41%	4.00%
Net interest margin (1)	4.47%	4.49%
Efficiency Ratio (2)	70.30%	69.87%
Earnings per share (3)	\$ 1.04	\$ 1.19

- (1) On a fully taxable equivalent basis and including loan origination fees
- (2) Non-interest expenses for the period indicated divided by the sum of net interest income and non-interest income for the period indicated.
- (3) Per weighted average shares of common stock outstanding for the period indicated.

Net Interest Income

2011 Compared to 2010

Net interest income, on a fully taxable equivalent basis, decreased 0.97% from 2010 to 2011. The decrease in net interest income was driven by changes in average rates earned on assets and paid on interest bearing liabilities and by changes in the relative mix of earning assets and interest bearing liabilities.

For the year ended December 31, 2011, the Company's average earning assets decreased 0.53%; the percent of average loan balances, the highest earning of the Company's earning assets, to total average earning assets decreased slightly to 86.79% in 2011 compared to 89.26% in 2010. The decrease in earning assets was more than offset by the decrease in interest bearing liabilities of 2.28% from 2010 to 2011. These changes in the relative mix of earning assets and interest bearing liabilities and the change in the average yields offset resulting in the decrease of the Company's net interest income.

Federal Reserve target rate for federal funds sold continues to impact yields on earning assets and average rates paid on interest bearing liabilities. The Company experienced declining rates for 2011 as compared to 2010 on all components of earning assets and on the savings and time deposit components of interest bearing liabilities.

The Company believes that its deposits will be sufficient to fund the current and expected loan demand. Should the loan demand increase beyond the Company's current expectations, the Company may be required to fund these loans with borrowings which could result in a reduction of net interest margin. However, management believes total net interest income would not be adversely affected.

Also, balances of non-performing loans and other real estate acquired through foreclosure have increased from December 31, 2010 to December 31, 2011. Increases in balances of non-accrual loans and other real estate acquired through foreclosure often have adverse effects on net interest income. Should balances of non-accrual loans and other real estate acquired through foreclosure continue to increase, net interest margin may decrease accordingly. Further discussion relating to the Company's loan portfolio and credit quality can be found as part of this Management's Discussion and Analysis under the headings of "Loan Portfolio" and "Credit Quality."

The table below illustrates the effects on net interest income of changes in average volumes of interest bearing liabilities and earning assets from 2010 to 2011 and changes in average rates on interest bearing liabilities and earning assets from 2010 to 2011 (in thousands of dollars):

EFFECT OF RATE-VOLUME CHANGES ON NET INTEREST (On a fully taxable equivalent basis)
Increase (Decrease) 2011 Compared to 2010

	Due to change in:					
	Averag	ge Volume	Avera	ige Rate	Total Change	
Interest Income						
Loans	\$	(695)	\$	(1,001)	\$	(1,696)
Taxable investment securities		131		(148)		(17)
Non-taxable investment securities		(58)		(25)		(83)
Interest bearing deposits		1		(3)		(2)
Federal funds sold		5		(1)		4
Total Interest Income		(616)		(1,178)		(1,794)
Interest Expense						
Demand deposits		2		(2)		0
Savings deposits		8		(55)		(47)
Time deposits		(234)		(1,313)		(1,547)
Borrowings		13		(50)		(37)
Total Interest Expense		(211)		(1,420)		(1,631)
•					-	
Net Interest Income	\$	(405)	\$	242	\$	(163)

The table below sets forth an analysis of net interest income for the years ended December 31, 2011 and 2010 (average balances and interest income/expense shown in thousands of dollars):

		Average alance(2)	2011 Income Expense	Yield /Rate(1)	Average alance(2)	2010 Income Expense	Yield /Rate(1)
Earning Assets							
Loans(3)(4)	\$	321,908	\$ 20,448	6.35%	\$ 332,846	\$ 22,144	6.65%
Taxable investment securities		32,156	608	1.89%	25,243	625	2.48%
Non-taxable investment securities		1,826	69	3.78%	3,357	152	4.53%
Interest bearing deposits		3,272	6	.18%	2,928	8	.27%
Federal funds sold		11,742	 18	.15%	8,502	 14	.16%
Total Earning Assets		370,904	21,149	5.70%	372,876	22,943	6.15%
Allowance for loan losses		(5,635)			(4,811)		
Other non-earning assets		40,239			40,705		
Total Assets	<u>\$</u>	405,508			\$ 408,770		
Interest Bearing Liabilities							
Demand deposits	\$	24,740	\$ 29	.12%	\$ 23,337	\$ 29	.12%
Savings deposits		56,314	128	.23%	52,857	176	.33%
Time deposits		207,423	3,988	1.92%	219,593	5,535	2.52%
Long-term debt		10,742	438	4.07%	10,412	474	4.55%
Total Interest Bearing Liabilities		299,219	4,583	1.53%	306,199	6,214	2.03%
Demand deposits		57,550			53,771		
Other liabilities		7,942			9,007		
Stockholders' equity		40,797			39,793		
Total Liabilities and Stockholders' Equity	\$	405,508			\$ 408,770		
Net Interest Income			\$ 16,566			\$ 16,729	
Net Yield on Earning Assets				4.47%			4.49%

- Yields are computed on a taxable equivalent basis using a 30% tax rate Average balances are based upon daily balances Includes loans in non-accrual status Income on loans includes fees
- (1) (2) (3) (4)

Loan Portfolio

The Company is an active residential mortgage and construction lender and extends commercial loans to small and medium sized businesses within its primary service area. The Company's commercial lending activity extends across its primary service areas of Grant, Hardy, Hampshire, Mineral, Randolph, Tucker and Pendleton counties in West Virginia and Frederick County, Virginia. Consistent with the Company's focus on providing community-based financial services, the Company does not attempt to diversify its loan portfolio geographically by making significant amounts of loans to borrowers outside of its primary service area.

The table below summarizes the Company's loan portfolio at December 31, 2011, 2010, 2009, 2008 and 2007 (in thousands of dollars):

	2011	2010	2009	2008	2007
Real estate mortgage	\$ 162,214	\$ 168,226	\$ 162,619	\$ 156,877	\$ 169,122
Real estate construction	23,711	33,746	30,759	27,210	15,560
Commercial	101,517	97,089	97,606	97,709	79,892
Installment	25,614	30,275	44,499	43,958	45,625
Total Loans	313,056	329,336	335,483	 325,754	310,199
Allowance for loan losses	(6,111)	(5,407)	(4,021)	(3,667)	(3,577)
intowance for four fosses	 (0,111)	 (0,107)	 (1,021)	 (3,007)	 (3,511)
Net Loans	\$ 306,945	\$ 323,929	\$ 331,462	\$ 322,087	\$ 306,622

There were no foreign loans outstanding during any of the above periods.

The following table illustrates the Company's loan maturity distribution as of December 31, 2011 (in thousands of dollars):

	Maturity Range								
	Less than 1 Year			1-5 Years		ver 5 Years		Total	
<u>Loan Type</u>						<u></u>		<u>.</u>	
Commercial	\$	34,889	\$	19,231	\$	47,397	\$	101,517	
Real estate mortgage and construction		49,198		33,334		103,393		185,925	
Installment		5,695		16,774		3,145		25,614	
Total Loans	\$	89,782	\$	69,339	\$	153,935	\$	313,056	

Credit Quality

The principal economic risk associated with each of the categories of loans in the Company's portfolio is the creditworthiness of its borrowers. Within each category, such risk is increased or decreased depending on prevailing economic conditions. The risk associated with the real estate mortgage loans and installment loans to individuals varies based upon employment levels, consumer confidence, fluctuations in value of residential real estate and other conditions that affect the ability of consumers to repay indebtedness. The risk associated with commercial, financial and agricultural loans varies based upon the strength and activity of the local economies of the Company's market areas. The risks associated with real estate construction loans vary based upon the supply of and demand for the type of real estate under construction.

An inherent risk in the lending of money is that the borrower will not be able to repay the loan under the terms of the original agreement. The allowance for loan losses (see subsequent section) provides for this risk and is reviewed at least quarterly for adequacy. This review also considers concentrations of loans in terms of geography, business type or level of risk. While lending is geographically diversified within the service area, the Company does have some concentration of loans in the area of agriculture (primarily poultry farming), and the timber and coal extraction industries. The Company recognizes these concentrations and considers them when structuring its loan portfolio.

Non-performing loans include non-accrual loans and loans 90 days or more past due (including non-performing restructured loans). Non-accrual loans are loans on which interest accruals have been discontinued. Loans are typically placed in non-accrual status when the collection of principal or interest is 90 days past due and collection is uncertain based on the net realizable value of the collateral and/or the financial strength of the borrower. Also, the existence of any guaranties by federal or state agencies is given consideration in this decision. The policy is the same for all types of loans. Non-performing loans do not represent or result from trends or uncertainties which management reasonably expects will materially impact future operating results, liquidity, or capital resources.

The following table summarizes the Company's non-performing loans, restructured loans accruing interest and other real estate owned at December 31, 2011 and December 31, 2010 (in thousands of dollars):

	Γ	December 31, 2011	De	December 31, 2010		
Loans on non-accrual status	\$	8,021	\$	6,979		
Loans delinquent 90 days or more still accruing	\$	536	\$	866		
Total non-performing loans	\$	8,557	\$	7,845		
Restructured loans still accruing	\$	13,055	\$	1,037		
Other real estate owned (OREO)	\$	7,070	\$	4,700		
Total non-performing loans and other risk assets	\$	28,682	\$	13,582		

Restructured loans are loans on which the interest rate or repayment terms have been changed due to financial hardship of the borrower. Restructured loans that are performing in accordance with modified terms are \$11,233,000 and \$5,219,000 at December 31, 2011 and December 31, 2010, respectively. Restructured loans not performing in accordance with modified terms totaled \$2,919,000 as of December 31, 2011. All restructured loans are included in impaired loans in Note Five. The increase in restructured loans is the result of including loan balloon renewal agreements for troubled borrowers in accordance with the new guidelines adopted with ASU 2011-02.

The carrying value of real estate acquired through foreclosure was \$7,070,000 at December 31, 2011 and \$4,700,000 at December 31, 2010. The Company's practice is to value real estate acquired through foreclosure at the lower of (i) an independent current appraisal or market analysis less anticipated costs of disposal, or (ii) the existing loan balance. The Company does not anticipate further losses from the disposal of other real estate owned.

Because of its large impact on the local economy, management continues to monitor the economic health of the poultry industry. The Company has direct loans to poultry growers and the industry is a large employer in the Company's trade area. In addition, multiple manufacturers of household cabinetry are large employers in the Company's primary trade area. Due to the downturn in the housing market nationally, there have been indications that the demand for cabinetry has decreased, impacting the performance of these manufacturers. Because of the impact on the local economy, management has begun to monitor the performance of this industry as it relates to local employment trends. Additionally, the Company's loan portfolio contains a segment of loans collateralized by heavy equipment, particularly in the trucking, mining and timber industries. Because of the impact of the slowing economic conditions on the housing market, the timber sector has experienced a recent downturn. While the Company has experienced some losses related to the downturn in this industry, no material losses related to foreclosures of loans collateralized by assets typical to the timber harvest industry have occurred. This industry has seen some improvement during the current year, resulting in reduced financial stresses on the Company's borrowers.

Allowance For Loan Losses

The allowance for loan losses is an estimate of the losses in the current loan portfolio. The allowance is based on two principles of accounting: (i) ASC 450, "Contingencies" which requires that losses be accrued when they are probable of occurring and estimable and (ii) ASC 310, "Receivables", which requires that loans be identified which have characteristics of impairment as individual risks (e.g. the collateral, present value of cash flows or observable market values are less than the loan balance).

Each of the Company's banking subsidiaries determines the adequacy of its allowance for loan losses independently using the same allowance for loan loss methodology. The allowance is calculated quarterly and adjusted prior to the issuance of the quarterly financial statements. All loan losses charged to the allowance are approved by the boards of directors of each bank review the allowance methodology for consistency and reasonableness. The allowance is reviewed for adequacy after considering historical loss rates, current economic conditions (both locally and nationally) delinquency trends and charge-off activity, status of past due and non-performing loans, growth within the portfolio, the amount and types of loans comprising the loan portfolio, adverse situations that may affect a borrower's ability to pay, the estimated value of underlying collateral, prevailing economic conditions and any known credit problems that have not been considered elsewhere in the calculation. Although the loan portfolios of the two banks are similar to each other, some differences exist which result in divergent risk patterns and different historical charge-off rates amongst the functional areas of the banks' loan portfolios. Each bank pays particular attention to the individual loan performance, collateral values, borrower financial conditions and economic conditions. A committee, with representatives from both subsidiary banks, meets to discuss the overall economic conditions that impact both subsidiary banks in the same fashion.

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

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Banks do not separately identify individual consumer and residential loans for impairment disclosures, unless the loans are the subject of a restructuring agreement.

Impaired loans and their resulting valuation allowance are disclosed in the table below.

	Decembe	r 31, 2011	December 31, 2010			
		Id	dentified			Identified
Loan Type	Balance	In	pairment	Balance		Impairment
Commercial mortgage	\$ 26,543	\$	1,018	\$ 24,147	\$	904
Commercial other	691		167	988		21
Consumer mortgage	1,966		328	253		0
	\$ 29,200	\$	1,513	\$ 25,388	\$	925

The second step is to allocate losses to non-impaired loans based on historical loss rates of loans, by category, and considering the potential impact of other qualitative factors on future loan performance.

Management has determined that the allowance for loan losses is adequate to absorb any losses inherent in the portfolio. Although management believes that it uses the best information available to make such determinations, future adjustments to the allowance for loan losses may be necessary, and the results of operations could be significantly and adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that material increases will not be necessary should the quality of the loans deteriorate as a result of factors previously discussed

Both banks have outsourced independent loan review performed at least annually, the results of which are reviewed by both bank boards and the Company's audit committee, with changes factored into the allowance calculations. Independent outsourced loan review considers the adequacy of loan underwriting, asset quality, the accuracy of the banks' loan risk ratings and the appropriateness of specific reserves as well as the overall reasonableness of the allowance for loan losses.

Provisions for loan losses are charged to operations in order to maintain the allowance for loan losses at a level management considers adequate to absorb credit losses inherent in the loan portfolio. Credit exposures deemed uncollectible are charged against the allowance for loan losses. Recoveries of previously charged-off loans are credited to the allowance for loan losses. During 2011, the Company's net charge-offs, as compared to gross loan balances, was greater than that experienced in 2010. As a result of the impact of increased net charge-offs, the Company's provision for loan losses during 2011 was \$137,000 greater than in 2010. The Company's ratio of allowance for loan losses to gross loans increased from 1.64% at December 31, 2011. At December 31, 2011, the ratio of the allowance for loan losses to non-performing loans was 71.43% compared to 68.93% at December 31, 2010.

Cumulative net loan losses, after recoveries, for the five-year period ending December 31, 2011 are as follows (in thousands of dollars):

	Dollars	Percent of Total
Commercial	\$ 4,066	50%
Real Estate	2,255	28%
Consumer	 1,771	22%
Total	\$ 8,092	

An analysis of the changes in the allowance for loan losses is set forth in the following table (in thousands of dollars):

\$ 5,407	Ф							2007
-,	\$	4,021	\$	3,667	\$	3,577	\$	3,482
2,485		849		492		198		540
		1,230				228		47
		668				524		494
3,422		2,747		1,800		950		1,081
266		144		10		20		59
15		167		72		2		4
221		335		208		109		276
502		646		290		131		339
2,920		2,101		1,510		819		742
 3,624		3,487		1,864		909		837
\$ 6,111	\$	5,407	\$	4,021	\$	3,667	\$	3,577
92%		63%		46%		26%		.24%
<u>s</u>	565 372 3,422 266 15 221 502 2,920 3,624	565 372 3,422 266 15 221 502 2,920 3,624 \$ 6,111 \$	565 1,230 372 668 3,422 2,747 266 144 15 167 221 335 502 646 2,920 2,101 3,624 3,487 \$ 6,111 \$ 5,407	565 1,230 372 668 3,422 2,747 266 144 15 167 221 335 502 646 2,920 2,101 3,624 3,487 \$ 6,111 \$ 5,407 \$	565 1,230 445 372 668 863 3,422 2,747 1,800 266 144 10 15 167 72 221 335 208 502 646 290 2,920 2,101 1,510 3,624 3,487 1,864 \$ 6,111 \$ 5,407 \$ 4,021	565 1,230 445 372 668 863 3,422 2,747 1,800 266 144 10 15 167 72 221 335 208 502 646 290 2,920 2,101 1,510 3,624 3,487 1,864 \$ 6,111 \$ 5,407 \$ 4,021 \$	565 1,230 445 228 372 668 863 524 3,422 2,747 1,800 950 266 144 10 20 15 167 72 2 221 335 208 109 502 646 290 131 2,920 2,101 1,510 819 3,624 3,487 1,864 909 \$ 6,111 \$ 5,407 \$ 4,021 \$ 3,667	565 1,230 445 228 372 668 863 524 3,422 2,747 1,800 950 266 144 10 20 15 167 72 2 221 335 208 109 502 646 290 131 2,920 2,101 1,510 819 3,624 3,487 1,864 909 \$ 6,111 \$ 5,407 \$ 4,021 \$ 3,667 \$

The table below shows the allocation of loans in the loan portfolio and the corresponding amounts of the allowance allocated by loan type (dollar amounts in thousands of dollars):

		201	1		2	2010			2009		200	08			2	007	
			Percent			Po	ercent			Percent		Percen	t				Percent
			of				of			of		of					of
	A	mount	Loans	1	Amount	I	oans	Amount		Loans	Amount	Loans		A	mount		Loans
Commercial	\$	3,363	32%	\$	2,232		30%	\$ \$ 1,669		29%	\$ 1,349		30%	\$	1,140		26%
Real Estate		1,959	59%		1,662		61%	1,034		58%	994		57%		1,200		59%
Consumer		428	9%		968		9%	1,220		13%	1,285		13%		1,172		15%
Unallocated		361	0%		545		0%	98		0%	39		0%		65		0%
Totals	\$	6,111	100%	\$	5,407		100%	\$ \$ 4,021		100%	\$ 3,667		100%	\$	3,577		100%

As certain loans identified as impaired are paid current, collateral values increase or loans are removed from watch lists for other reasons, and as other loans become identified as impaired, the allocation of the allowance among the loan types may change. The allocation also changes because delinquency levels within each of the respective portfolios change. The Company feels that the allowance is a fair representation of the losses present in the portfolio given historical loss trends, economic conditions and any known credit problems as of any quarter's end. The Company believes that the allowance is to be taken as a whole, and allocation between loan types is an estimation of potential losses within each loan type given information known at the time.

Non-Interest Income

2011 Compared to 2010

Non-interest income increased 0.33%, or \$7,000 from 2010 to 2011.

The increase in non-interest income was the result of increase in life insurance investment income in excess of the decreases in overdraft fees, service charge fees, and non-recurring gains on the sale of securities during 2010.

Service charges on deposit accounts decreased 7.57%. The largest portion of these charges is non-sufficient funds fees on non-interest bearing transaction accounts. The subsidiary banks continued to see decreases in service charges associated with the program commonly referred to as the "courtesy overdraft" program. This is the result of customer's choice not to participate in the subsidiary bank's automatic overdraft protection coupled with better management, by customers, of their accounts.

Net insurance earnings and commissions decreased \$37,000 from 2010 to 2011. Insurance earnings for the Company consist of commissions earned by the subsidiary banks on life and accident and health insurance sold in relation to the extension of credit and insurance revenues, net of benefits paid, expense allowances and policy and claim reserves earned by the life insurance subsidiary. As the Company's balances of installment loans and the volume of installment loans, which are primary markets for credit life and accident and health insurance, have decreased over the past several years, gross revenues from insurance earnings have decreased. In relation to this decrease, required policy reserves have also declined. The table below illustrates the components of insurance commissions and income for 2010 and 2011 (in thousands of dollars), which is reported as other operating income.

D	:	2011		2010		crease)
Revenues	Φ.	100	Ф	1.50	Ф	(2.5)
Gross commissions and insurance revenues	\$	123	\$	158	\$	(35)
Expenses						
Benefits Paid		17		8		9
Changes in required policy and claim reserves		(43)		(55)		12
Expense allowance		49		68		(19)
Total Expenses		23		21		(2)
Net insurance income	\$	100	\$	137	\$	(37)

Non-interest Expense

2011 compared to 2010

Non-interest expense increased 0.27% in 2011 as compared to 2010.

Changes in salary and benefits expense

The following table compares the components of salary and benefits expense for the twelve month periods ended December 31, 2011 and 2010 (in thousands of dollars):

Salary and Benefits Expense

				Increase
	2011	2010	((Decrease)
Employee salaries	\$ 4,450	\$ 4,493	\$	(43)
Employee benefit insurance	1,165	1,117		48
Payroll taxes	359	351		8
Deferred loan origination costs	(198)	0		(198)
Non-recurring post retirement adjustment	(70)	0		(70)
Post retirement plans	719	975		(256)
Total	\$ 6,425	\$ 6,936	\$	(511)

The decrease of 7.37% in employee related cost during 2011 compared to 2010 is mainly the result of the implementation of the Financial Accounting Standard ASC 310-20 Nonrefundable Fees and Other Costs. The Company began deferral of costs associated with loan origination at the beginning of 2011 and is amortizing the cost over the life of the loan. Additionally, the Company did not contribute to the discretionary employee stock ownership plan or the profit sharing plan during 2011 as part of a cost cutting initiative for 2011 which also included a reduction in director fees paid.

Changes in data processing expense

Data processing expense increased 5.09% or \$56,000 during 2011 compared to 2010. The increase was driven by a credit received from the Company's core system vendor during 2010 for an error in billing during the system conversion in the fall of 2009 partially offset by additional costs attributed to increased costs at one of the subsidiary banks as a result of increase in the number of customer deposit accounts, internet banking costs, and a full year of costs during 2011 for a branch location which was not open the full year in 2010.

Changes in occupancy and equipment expense

The following table illustrates the components of occupancy and equipment expense for the twelve month periods ended December 31, 2011 and 2010 (in thousands of dollars):

	2	2011	 2010	(<u>L</u>	Decrease)
Depreciation of buildings and equipment	\$	783	\$ 787	\$	(4)
Maintenance expense on buildings and equipment		344	369		(25)
Utilities expense		144	133		11
Real estate and personal property tax		105	100		5
Other expense related to occupancy and equipment		107	98		9
Total occupancy and equipment expense	\$	1,483	\$ 1,487	\$	(4)

Increase

Occupancy and equipment expenses decreased 0.3% during 2011 compared to 2010. Increases in utilities and taxes were offset by decreases in maintenance expenses.

Other changes in non-interest expense

Director fees decreased by 14.43% during 2011 driven by the number of meetings held during 2011 compared to 2010 and a reduction in fees paid to directors per meeting.

Legal and professional fees decreased by \$95,000 or 15.73% from 2010 to 2011 driven by non-recurring legal expenses incurred during 2010 and a reduction in third party internal audit fees compared to 2010.

Office supplies and postage and freight expenses decreased 14.99% or \$61,000 during 2011 compared to 2010, largely driven by the reduction of courier services between branches.

FDIC premium expense decreased 21.45% or \$142,000 during 2011 compared to 2010 driven by the decreased premiums rates adjusted by the FDIC during 2011.

Loan and foreclosed asset expenses increased 153.35% or \$871,000 during 2011 compared to 2010 due to the increased number of foreclosures during 2011, valuation adjustments on foreclosed properties, and increased costs associated with obtaining updated appraisals on impaired relationships.

The table below illustrates components of other non-interest expense for 2011 and 2010 (in thousands of dollars). Significant other non-interest expense are in the following table:

					increase
	2	2011	2010	(I	Decrease)
ATM expense	\$	(109)	\$ (72)	\$	(37)
Advertising and marketing expense		150	158		(8)
Amortization of intangible assets		187	190		(3)
Franchise taxes		116	96		20
Miscellaneous components of other non-interest expense		590	 584		6
Total	\$	934	\$ 956	\$	(22)

Securities Portfolio

The Company's securities portfolio serves several purposes. Portions of the portfolio are used to secure certain public deposits. The remaining portfolio is held as investments or used to assist the Company in liquidity and asset liability management. Total securities, including restricted securities, represented 10.22% of total assets and 99.10% of total shareholders' equity at December 31, 2011.

The securities portfolio typically will consist of three components: securities held to maturity, securities available for sale and restricted securities are classified as held to maturity when management has the intent and the Company has the ability at the time of purchase to hold the securities to maturity. Held to maturity securities are carried at cost, adjusted for amortization of premiums and accretion of discounts. Securities to be held for indefinite periods of time are classified as available for sale and accounted for at market value. Securities available for sale include securities that may be sold in response to changes in market interest rates, changes in the security's prepayment risk, increases in loan demand, general liquidity needs and other similar factors. Restricted securities are those investments purchased as a requirement of membership in certain governmental lending institutions and cannot be transferred without the issuer's permission. The Company's purchases of securities have generally been limited to securities of high credit quality with short to medium term maturities.

The Company identifies at the time of acquisition those securities that are available for sale. These securities are valued at their market value with any difference in market value and amortized cost shown as an adjustment in stockholders' equity. Changes within the year in market values are reflected as changes in other comprehensive income, net of the deferred tax effect. As of December 31, 2011, the fair value of the securities available for sale exceeds their cost basis by \$430,000 (\$271,000 after tax effect of \$159,000).

The table below summarizes the carrying value of the Company's securities at December 31, 2011, 2010 and 2009 (in thousands of dollars):

	2011	Carry Dece	ble for Sale ring Value mber 31, 2010	2009
U.S. Treasuries and Agencies	\$ 21,932	\$	9,258	\$ 12,426
Mortgage backed securities	5,604		5,651	5,836
Collateralized mortgage obligations	3,413		1,764	0
State and municipals	2,698		2,157	3,946
Certificates of deposit	5,910		6,465	4,703
Marketable equities	0		29	25
Total	\$ 39,557	\$	25,324	\$ 26,936

The carrying amount and estimated market value of securities (in thousands of dollars) at December 31, 2011 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.

	Amor	tized Cost	Fa	ir Value	Equivalent Average Yield
Securities Available for Sale					
Due in next twelve months	\$	9,495	\$	9,572	1.80%
Due after one year through five		20,788		20,968	1.39%
Due beyond five years		3,388		3,413	2.14%
Mortgage backed securities		5,456		5,604	2.48%
Total Available For Sale	\$	39,127	\$	39,557	1.71%

Yields on tax exempt securities are stated at actual yields.

Any changes in market values of securities deemed by management to be attributable to reasons other than changes in market rates of interest would be recorded through results of operations. It is the Company's determination that all securities held at December 31, 2011 which have fair values less than the amortized cost, have these gross unrealized losses related to increases in the current interest rates for similar issues of securities, and that no material impairment for any securities in the portfolio exists because of downgrades of the securities or as a result of a change in the financial condition of any of the issuers. A summary of the length of time of unrealized losses for all securities held at December 31, 2011 can be found in the footnotes to the consolidated financial statements. The Company reviews all securities with unrealized losses, and all securities in the portfolio on a regular basis to determine whether the potential for other than temporary impairment exists. One of the criteria for making this determination is the rating given to each bond by the major ratings agencies, Moody's and Standard & Poors.

A summary of the Company's securities portfolio at December 31, 2011, based on the ratings of the securities in the portfolio given by these ratings agencies, is shown below (in thousands of dollars):

		Amo	ortized Cost	Gros	ss Unrealized Gains	Unre	Gross alized Losses	M	arket Value
Ratings Provided by R	Ratings Agencies				_				_
Moody's	<u>S&P</u>								
U.S. Treasuries and Agencies									
Aaa	AA+	\$	17,655	\$	158	\$	4	\$	17,809
No Rating	No Rating		4,086		37		0		4,123
Mortgage Backed Securities									
MBS Agency	MBS Agency		5,456		151	\$	3		5,604
Commercial Mortgage Obligations									
MBS Agency	MBS Agency		3,387		37		11		3,413
State and Municipals									
Aa3	AA-		951		43		0		994
Aa2	AA		1,094		9		0		1,103
No Rating	AA-		402		4		0		406
No Rating	No Rating		195		0		0		195
			23						

Deposits

The Company's primary source of funds is local deposits. The Company's deposit base is comprised of demand deposits, savings and money market accounts and other time deposits. The majority of the Company's deposits are provided by individuals and businesses located within the communities served.

Total balances of deposits increased 0.4% from December 31, 2010 to December 31, 2011.

A summary of the maturity range of time deposits over \$100,000 is as follows (in thousands of dollars):

			At De	cember 31,		
	2011			2010		2009
Three months or less	\$	10,472	\$	11,725	\$	11,133
Four to twelve months		32,040		36,431		36,512
One year to three years		22,066		22,419		23,447
Four years to five years		9,534		4,428		4,504
Total	\$	74,112	\$	75,003	\$	75,596

Debt Instruments

Long-Term Borrowings

The Company borrows funds from the Federal Home Loan Bank ("FHLB") to reduce market rate risks or to provide operating liquidity. The Company typically will initiate these borrowings in response to a specific need for managing market risks or for a specific liquidity need and will attempt to match features of these borrowings to best suit the specific need. Therefore, the borrowings on the Company's balance sheet as of December 31, 2011 and throughout the twelve month period ended December 31, 2011 have varying features of amortization or single payment with periodic, regular interest payment and also have interest rates which vary based on the terms and on the features of the specific borrowing. More information regarding the Company's FHLB advances can be found in Note Thirteen of the consolidated financial statements.

Short-Term Borrowings

As it becomes necessary for short-term liquidity needs and when beneficial for assisting in managing profitability the Company will periodically utilize either the FHLB or other available credit facilities for overnight or other short term borrowings. The use of short-term debt instruments is not a frequently utilized borrowing mechanism of the Company; however, during the third quarter of 2010, circumstances prescribed use of these borrowing facilities. At December 31, 2011, the Company had no balance in overnight and other short-term borrowings.

Capital Resources

The assessment of capital adequacy depends on a number of factors such as asset quality, liquidity, earnings performance and changing competitive conditions and economic forces. The Company seeks to maintain a strong capital base to support growth and expansion activities, to provide stability to current operations, and to promote public confidence.

The Company's capital position continues to exceed regulatory minimums. The primary indicators relied on by the Federal Reserve Board and other bank regulators in measuring strength of capital position are the Tier 1 Capital, Total Capital and Leverage ratios. Tier 1 Capital consists of common stockholders' equity adjusted for unrealized gains and losses on securities. Total Capital consists of Tier 1 Capital and a portion of the allowance for loan losses. Risk-based capital ratios are calculated with reference to risk-weighted assets, which consist of both on and off-balance sheet risks.

The capital management function is an ongoing process. The Company looks first and foremost to maintain capital levels adequate to satisfy regulatory requirements through earnings retention. The maintenance of capital adequacy is weighed against the management of capital for satisfactory return on equity, typically via use of dividends and/or share repurchases. During 2011, the Company's capital position increased \$306,000 versus the decrease of \$54,000 during 2010. The return on average equity was 3.41% in 2011 compared to 4.00% for 2010. Total cash dividends declared represented 43.25% of net income for 2011 compared to 87.39% for 2010. Book value per share was \$31.17 at December 31, 2011 compared to \$30.94 at December 31, 2010.

Liquidity

Operating liquidity is the ability to meet present and future financial obligations. Short-term liquidity is provided primarily through cash balances, deposits with other financial institutions, federal funds sold, non-pledged securities and loans maturing within one year. Additional sources of liquidity available to the Company include, but are not limited to, loan repayments, the ability to obtain deposits through the adjustment of interest rates and the purchasing of federal funds. To further meet its liquidity needs, the Company also maintains lines of credit with correspondent financial institutions, the Federal Reserve Bank of Richmond, and the Federal Home Loan Bank of Pittsburgh.

Historically, the Company's primary need for additional levels of operational liquidity has been to fund increases in loan balances. The Company has normally funded increases in loans by increasing deposits and balances of borrowed funds and decreases in secondary liquidity sources such as balances of federal funds sold and balances of securities. The Company maintains credit facilities which are typically sufficient to adequately fulfill any short-term liquidity needs, and management of deposit balances and long term borrowings are utilized for longer term liquidity management. Increases in liquidity requirements may cause the Company to offer above market rates on deposit products to attract new depositors, which would impact the Company's net interest income.

The Company's operating funds, funds with which to pay shareholder dividends and funds for the exploration of new business ventures have been supplied primarily through dividends paid by the Company's two subsidiary Banks, Capon Valley Bank and The Grant County Bank. The various regulatory authorities impose restrictions on dividends paid by a state bank. A state bank cannot pay dividends without the consent of the relevant banking authorities in excess of the total net profits of the current year and the combined retained profits of the previous two years. As of December 31, 2011, the subsidiary Banks could pay dividends to the Company of approximately \$3,307,000 without permission of the regulatory authorities.

Effects of Inflation

Inflation primarily affects industries having high levels of property, plant and equipment or inventories. Although the Company is not significantly affected in these areas, inflation does have an impact on the growth of assets. As assets grow rapidly, it becomes necessary to increase equity capital at proportionate levels to maintain the appropriate equity to asset ratios. Traditionally, the Company's earnings and high capital retention levels have enabled the Company to meet these needs.

The Company's reported earnings results have been minimally affected by inflation. The different types of income and expense are affected in various ways. Interest rates are affected by inflation, but the timing and magnitude of the changes may not coincide with changes in the consumer price index. The Company actively monitors interest rate sensitivity in order to minimize the effects of inflationary trends on interest rates. Other areas of non-interest expenses may be more directly affected by inflation.

Item7A. Quantitative and Qualitative Disclosures About Market Risk

Not required for smaller reporting companies.

Item 8. Financial Statements and Supplementary Data

HIGHLANDS BANKSHARES, INC. CONSOLIDATED BALANCE SHEETS (In thousands of dollars)

	December 31, 2011		December 31, 2010			
ASSETS						
Cash and due from banks	\$ 9,321	\$	8,282			
Interest bearing deposits in banks	2,329		3,532			
Federal funds sold	11,253		5,836			
Investment securities available for sale	39,557		25,324			
Restricted investments, at cost	1,741		2,087			
Loans	313,056		329,336			
Allowance for loan losses	(6,111)	(5,407)			
Bank premises and equipment, net of depreciation	9,411		9,901			
Interest receivable	1,513		1,791			
Investment in life insurance contracts	7,300		7,031			
Foreclosed assets, net of valuation allowance	7,070		4,700			
Goodwill	1,534		1,534			
Other intangible assets, net of amortization	660		830			
Other assets	5,560		5,123			
Total Assets	\$ 404,194	\$	399,900			
LIABILITIES						
Deposits						
Non-interest bearing deposits	\$ 61,710	\$	54,693			
Interest bearing transaction and savings accounts	82,915		77,392			
Time deposits over \$100,000	74,112		75,003			
All other time deposits	125,335		135,724			
Total Deposits	344,072		342,812			
	•		Í			
Long term debt instruments	11,245		9,393			
Accrued expenses and other liabilities	7,203		6,327			
Total Liabilities	362,520		358,532			
STOCKHOLDERS' EQUITY						
Common Stock, \$5 par value, 3,000,000 shares authorized, 1,436,874 shares issued, 1,336,873 shares outstanding	7,184		7,184			
Surplus	1,662		1,662			
Treasury stock (100,001 shares, at cost)	(3,372)	(3,372)			
Retained earnings	37,955		37,165			
Other accumulated comprehensive income (loss)	(1,755)	(1,271)			
Total Stockholders' Equity	41.674		41,368			
Louis Stockholder Default	11,071	_	,500			
Total Liabilities and Stockholders' Equity	\$ 404,194	\$	399,900			

The accompanying notes are an integral part of these financial statements

HIGHLANDS BANKSHARES, INC. CONSOLIDATED STATEMENTS OF INCOME (In Thousands of Dollars, Except Per Share Data)

	Twelve Month	ıs Ended De	nded December 31 2010		
Interest Income					
Interest and fees on loans	\$ 20,448		22,144		
Interest on federal funds sold	18		14		
Interest on deposits in other banks			8		
Interest and dividends on securities	658		731		
Total Interest Income	21,130		22,897		
Interest Expense					
Interest on deposits	4,145		5,740		
Interest on borrowed money	438		474		
Total Interest Expense	4,583		6,214		
Net Interest Income	16,547	,	16,683		
Provision for Loan Losses	3,624	<u> </u>	3,487		
Net Interest Income After Provision for Loan Losses	12,923	<u> </u>	13,196		
Non-interest Income					
Service charges	1,441		1,559		
Life insurance investment income	325		120		
Gains on securities transactions	15		52		
Other non-interest income	371		414		
Total Non-interest Income	2,152		2,145		
Non-interest Expense					
Salaries and employee benefits	6,425	j	6,936		
Occupancy and equipment expense	1,483	j	1,487		
Data processing expense	1,157	1	1,101		
Directors fees	332	<u> </u>	388		
Legal and professional fees	509)	604		
Office supplies, postage and freight expense	346	,	407		
FDIC premiums	520)	662		
Loan and foreclosed asset expense	505	,	426		
Losses on sale of foreclosed property	22		54		
Losses on impairment of other real estate	912		88		
Other non-interest expense	934		956		
Total Non-interest Expense	13,145		13,109		
Income Before Provision For Income Taxes	1,930)	2,232		
Provision for Income Taxes	538	<u></u>	640		
Net Income	<u>\$ 1,392</u>	<u>\$</u>	1,592		
Per Share Data					
Net Income	\$ 1.04	1 \$	1.19		
Cash Dividends	\$ 0.45		1.04		
Weighted Average Common Shares Outstanding	1,336,873	j	1,336,873		

The accompanying notes are an integral part of these financial statements.

HIGHLANDS BANKSHARES, INC. CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY Twelve Months Ended December 31, 2011 and 2010 (In Thousands of Dollars)

	ommon Stock	S	Surplus	Treas	sury Stock	Retained Carnings	Com _I	umulated Other prehensive ncome Loss)		Total
Balances at December 31, 2009	\$ 7,184	\$	1,662	(\$	3,372)	\$ 36,963	(\$	1,015)	\$	41,422
Comprehensive Income										
Net Income Other comprehensive income, net of tax:						1,592				1,592
Other comprehensive income, net of tax: Actuarial gain/(loss) on defined pension benefit plan, net of tax of \$86								(146)		
Unrealized gains or losses on investment securities available for sales, net of tax of \$45								(77)		
(Gain) on sale of securities, net of tax \$19 – reclassification adjustment								(33)		
Other comprehensive income, net of tax of \$150 Total Comprehensive Income								(256)	_	(256) 1,336
Dividends Paid						(1,390)				(1,390)
Balances December 31, 2010	\$ 7,184	\$	1,662	(\$	3,372)	\$ 37,165	(\$	1,271)	\$	41,368
Balances at December 31, 2010	\$ 7,184	\$	1,662	(\$	3,372)	\$ 37,165	(\$	1,271)	\$	41,368
Comprehensive Income										
Net Income Other comprehensive income, net of tax:						1,392				1,392
Actuarial (loss) on defined pension benefit plan, net of tax of \$317								(540)		
Unrealized gains or losses on investment securities available for sales, net of tax \$38								65		
(Gain) on sale of securities, net of tax of \$5 - reclassification adjustment								(9)		
Other comprehensive income, net of tax of \$284								(484)		(484)
Total Comprehensive Income										908
Dividends Paid						(602)				(602)
Balances December 31, 2011	\$ 7,184	\$	1,662	(\$	3,372)	\$ 37,955	(\$	1,755)	\$	41,674

The accompanying notes are an integral part of these financial statements

HIGHLANDS BANKSHARES, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS (In Thousands of Dollars)

		Twelve Months Er	nded December 31 2010	
Cash Flows From Operating Activities Net Income	\$	1.392	\$	1,592
Adjustments to reconcile net income to net cash provided by operating activities	\$	1,392	φ	1,392
(Gains) on securities transactions		(15)		(52)
Losses on sale of foreclosed property		22		52
Depreciation		783		787
Income from life insurance contracts		(325)		(120)
Net amortization of securities premiums		256		141
Provision for loan losses		3,624		3,487
Write-down on foreclosed assets		912		159
Deferred income tax (benefit) expense		(576)		(483)
Amortization of intangibles		187		190
Decrease in interest receivable		278		117
Decrease in other assets		440		857
Increase in accrued expenses		44		526
Net Cash Provided by Operating Activities		7,022		7,253
Cash Flows From Investing Activities				
Proceeds from sale of foreclosed assets and fixed assets		1,130		834
Proceeds from maturity of securities available for sale		2,915		19,650
Proceeds from sale of securities available for sale		9,087		0
Purchase of securities available for sale		(26,390)		(18,297)
Net change in other investments		346		98
Net change in interest bearing deposits in other banks		1,203		(1,652)
Net change in federal funds sold		(5,417)		3,100
Net decrease in loans		8,926		1,524
Purchase of property and equipment		(293)		(1,362)
Net Cash (Used in) Provided by Investing Activities		(8,493)		3,895
Cash Flows From Financing Activities				
Net change in time deposits		(11,280)		(13,719)
Net change in other deposit accounts		12,540		6,654
Proceeds from long term borrowing		3,500		0
Repayment of long term borrowings		(1,648)		(1,473)
Dividends paid in cash		(602)		(1,390)
Net Cash Provided by (Used in) Financing Activities		2,510		(9,928)
Net increase in Cash and Cash Equivalents		1,039		1,220
Cash and Cash Equivalents, Beginning of Period		8,282		7,062
Cash and Cash Equivalents, End of Period	\$	9,321	\$	8,282
Supplemental Disclosures				
Cash paid for income taxes	\$	1,132	\$	743
Cash paid for interest	\$	4,712	\$	6,382
Noncash Investing and Financing Activities for other real estate acquired in settlement of loans	\$	4,434	\$	2,522

The accompanying notes are an integral part of these financial statements.

NOTE ONE: SUMMARY OF OPERATIONS

Highlands Bankshares, Inc. (the "Company") is a bank holding company and operates under a charter issued by the State of West Virginia. The Company owns all of the outstanding stock of The Grant County Bank ("Grant") and Capon Valley Bank ("Capon"), which operate under charters issued by the State of West Virginia. The Company also owns all of the outstanding stock of HBI Life Insurance Company, Inc. ("HBI Life"), which operates under a charter issued by the State of Arizona. State chartered banks are subject to regulation by the West Virginia Division of Banking, The Federal Reserve Bank and the Federal Deposit Insurance Corporation, while the insurance company is regulated by the Arizona Department of Insurance. The Banks provide services to customers located mainly in Grant, Hardy, Hampshire, Mineral, Pendleton, Randolph and Tucker counties of West Virginia, including the towns of Petersburg, Keyser, Moorefield, Davis and Wardensville through ten locations and in the county of Frederick in Virginia through two locations. The insurance company sells life and accident coverage exclusively through the Company's subsidiary Banks.

NOTE TWO: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of Highlands Bankshares, Inc. and its subsidiaries conform to accounting principles generally accepted in the United States of America and to accepted practice within the banking industry.

(a) Principles of Consolidation

The consolidated financial statements include the accounts of The Grant County Bank, Capon Valley Bank and HBI Life Insurance Company, Inc. All significant inter-company accounts and transactions have been eliminated.

(b) Use of Estimates in the Preparation of Financial Statements

In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. A material estimate that is particularly susceptible to significant changes in the near term is the determination of the allowance for loan losses, which is sensitive to changes in local economic conditions, deferred tax and the fair value of financial instruments.

(c) Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand and non-interest bearing funds at correspondent institutions.

(d) Foreclosed Real Estate

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the lower of the loan balance or fair value, less cost to sell, at the date of foreclosure, establishing a new cost basis. Capitalized costs include accrued interest, and any costs that significantly improve the value of the properties. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the loser of carrying amount or the fair value less cost to sell. Gains and losses resulting from the sale or write-down of foreclosed real estate are recorded in other expenses. Revenue and expenses from operations and changes in the valuation allowance are also included in other operating expenses.

(e) Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at unpaid principal balances net of unearned interest and the allowance for loan losses. Interest income is computed using the effective interest method based on the daily amount of principal outstanding and is credited to income as earned.

Loans are considered past due when they are not paid in accordance with contractual terms. Past due loans are monitored by portfolio segment and by severity of delinquency – 30-59 days past due; 60-89 days past due; and 90 days and greater past due.

The accrual of interest on loans in all loan segments (nonaccrual loans) is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is well secured and in the process of collection. When a loan is placed on nonaccrual status, all unpaid interest credited to income in the current calendar year is reversed and all unpaid interest accrued in prior calendar years is charged against the allowance for loan losses. Interest payments received on nonaccrual loans are either applied against principal or reported as interest income according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

Securities

Securities that the Company has both the positive intent and ability to hold to maturity (at time of purchase) are classified as held to maturity securities. All other securities are classified as available for sale. Securities held to maturity are carried at historical cost and adjusted for amortization of premiums and accretion of discounts, using the effective interest method. Securities available for sale are carried at fair value with any valuation adjustments reported, net of deferred taxes, as other accumulated comprehensive income.

Restricted investments consist of investments in the Federal Home Loan Bank of Pittsburgh, the Federal Reserve Bank of Richmond and West Virginia Bankers' Title Insurance Company. Such investments are required as members of these institutions and these investments cannot be sold without a change in the members' borrowing or service levels. Because there is no readily determinable market value for these investments, restricted investments are carried at cost on the Company's balance sheet.

Interest and dividends on securities and amortization of premiums and discounts on securities are reported as interest income using the effective interest method. Gains (losses) realized on sales and calls of securities are determined using the specific identification method.

Investment securities are impaired when fair value is less than cost. An impairment is considered "other than temporary" if any of the following conditions are met: the Company intends to sell the security, it is more likely than not that the entity will be required to sell the security before the recovery of its amortized cost basis, or the Company does not expect to recover the security's entire amortized cost basis (even if the entity does not intend to sell). The Company does not have any securities impairment that is considered "other than temporary" at December 31, 2011 and 2010.

(g) Allowance For Loan Losses

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

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

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are determined to be impaired. For such loans, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan.

The general component covers non-impaired loans and is based on management's internal risk ratings as well as historical loss experience adjusted for qualitative factors. The following risk factors relevant to each portfolio segment are reviewed and evaluated:

- Changes in lending policies and procedures, including changes in underwriting standards or collection, charge-off and recovery practices.
- Changes in national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio, including unemployment trends
 and GDP and other leading economic indicators.
- Changes in the nature and volume of the portfolio.
- Changes in the experience, ability and depth of lending management and staff.
- Changes in the volume and severity of past due and classified loans, the volume of nonaccrual loans, troubled debt restructurings and other loan modifications.
- Changes in the quality of the Banks' loan review systems.
- The existence and effect of any concentrations of credit, and the changes in the level of such concentrations.
- Changes in the value of underlying collateral.
- The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing portfolio.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payment of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Impairment is measured on a loan by loan basis for commercial loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Banks do not separately identify individual consumer and residential loans for impairment disclosures, unless the loans are the subject of a restructuring agreement.

Authoritative accounting guidance does not specify how an institution should identify loans that are to be evaluated for collectability, nor does it specify how an institution should determine that a loan is impaired. Each subsidiary of the Company uses its standard loan review procedures in making those judgments so that allowance estimates are based on a comprehensive analysis of the loan portfolio. For loans that are individually evaluated and found to be impaired, the associated allowance is based upon the estimated fair value, less costs to sell, of any collateral securing the loan as compared to the existing balance of the loan as of the date of analysis.

All other loans, including individually evaluated loans determined not to be impaired, are included in a group of loans that are measured under the general component of the allowance for loan losses to provide for estimated credit losses that have been incurred on groups of loans with similar risk characteristics. The methodology for measuring estimated credit losses on groups of loans with similar risk characteristics is based on each group's historical net charge-off rate, adjusted for the effects of the qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the group's historical loss experience.

(h) Per Share Calculations

Earnings per share are based on the weighted average number of shares outstanding.

(i) Bank Premises and Equipment

Land is carried at cost. Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is charged to income over the estimated useful lives of the assets using a combination of the straight line and accelerated methods. The costs of maintenance, repairs, renewals, and improvements to buildings, equipment and furniture and fixtures are charged to operations as incurred. Gains and losses on routine dispositions are reflected in other income or expense.

(j) Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities and accrued pension liabilities, are reported along with net income as the components of comprehensive income.

(k) Bank Owned Life Insurance Contracts

The Company has invested in and owns life insurance policies on certain officers. The policies are designed so that the Company recovers the interest expenses associated with carrying the policies and the officer will, at the time of retirement, receive any earnings in excess of the amounts earned by the Company. The Company recognizes as an asset the net amount that could be realized under the insurance contract as of the balance sheet date. This amount represents the cash surrender value of the policies less applicable surrender charges. The portion of the benefits which will be received by the executives at the time of their retirement is considered, when taken collectively, to constitute a retirement plan. Authoritative accounting guidance requires that an employers' obligation under a deferred compensation agreement be accrued over the expected service life of the employee through their normal retirement date. Assumptions are used in estimating the present value of amounts due officers after their normal retirement date. These assumptions include the estimated income to be derived from the investments and an estimate of the Company's cost of funds in these future periods. In addition, the discount rate used in the present value calculation will change in future years based on market conditions.

(l) Advertising

Advertising costs are expensed as they are incurred. Advertising expense for the years ended December 31, 2011 and 2010 was \$150,000 and \$158,000, respectively.

(m) Goodwill and Other Intangible Assets

In accordance with authoritative accounting guidance, goodwill resulting from the purchase of a bank is not amortized over an estimated useful life, but is tested at least annually for impairment. Core deposit and other intangible assets include premiums paid for acquisitions of core deposits (core deposit intangibles) and other identifiable intangible assets. Intangible assets other than goodwill, which are determined to have finite lives, are amortized based upon the estimated economic benefits received, which is ten years for the core deposit intangibles.

Core deposit and other intangible assets include premiums paid for acquisitions of core deposits (core deposit intangibles) and other identifiable intangible assets related to business acquisitions. In addition to the intangible assets associated with the purchase of banking organizations, the Company also carries intangible assets related to the purchase of certain naming rights to a performing arts center in Petersburg, WV. This intangible asset is being amortized over four years.

(n) Income Taxes

Amounts provided for income tax expense are based on income reported for financial statement purposes rather than amounts currently payable under federal and state tax laws. Deferred taxes, which arise principally from differences between the period in which certain income and expenses are recognized for financial accounting purposes and the period in which they affect taxable income, are included in the amounts provided for income taxes.

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

Interest and penalties associated with unrecognized tax benefits would be classified as additional income taxes in the statement of income.

At December 31, 2011 there were no unrecognized tax benefits.

(o) Reclassifications

Certain reclassifications have been made to prior period balances to conform with the current year's presentation format.

(p) Recent Accounting Standards

Adoption of New Accounting Standards

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-06, "Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements." ASU 2010-06 amends Subtopic 820-10 to clarify existing disclosures, require new disclosures, and includes conforming amendments to guidance on employers' disclosures about postretirement benefit plan assets. ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years leginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

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

In December 2010, the FASB issued ASU 2010-28, "Intangible – Goodwill and Other (Topic 350) – When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts." The amendments in this ASU modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

In December 2010, the FASB issued ASU 2010-29, "Business Combinations (Topic 805) – Disclosure of Supplementary Pro Forma Information for Business Combinations." The guidance requires pro forma disclosure for business combinations that occurred in the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period. If comparative financial statements are presented, the pro forma information should be reported as though the acquisition date for all business combinations that occurred during the current year had been as of the beginning of the comparable prior annual reporting period. ASU 2010-29 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. The adoption of the new guidance did not have a material impact on the Company's consolidated financial statements.

The Securities Exchange Commission (SEC) issued Final Rule No. 33-9002, "Interactive Data to Improve Financial Reporting." The rule requires companies to submit financial statements in extensible business reporting language (XBRL) format with their SEC filings on a phased-in schedule. Large accelerated filers and foreign large accelerated filers using U.S. generally accepted accounting principles (GAAP) were required to provide interactive data reports starting with their first quarterly report for fiscal periods ending on or after June 15, 2010. All remaining filers were required to provide interactive data reports starting with their first quarterly report for fiscal periods ending on or after June 15, 2011. The Company has submitted financial statements in extensible business reporting language (XBRL) format with their SEC filings in accordance with the phased-in schedule.

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

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

In April 2011, the FASB issued ASU 2011-02, "Receivables (Topic 310) – A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring." The amendments in this ASU clarify the guidance on a creditor's evaluation of whether it has granted a concession to a debtor. They also clarify the guidance on a creditor's evaluation of whether a debtor is experiencing financial difficulty. The amendments in this ASU are effective for the first interim or annual period beginning on or after June 15, 2011. Early adoption is permitted. Retrospective application to the beginning of the annual period of adoption for modifications occurring on or after the beginning of the annual adoption period is required. As a result of applying these amendments, an entity may identify receivables that are newly considered to be impaired. For purposes of measuring impairment of those receivables, an entity should apply the amendments prospectively for the first interim or annual period beginning on or after June 15, 2011. The Company has adopted ASU 2011-02 and included the required disclosures in its consolidated financial statements.

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

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

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

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

In September 2011, the FASB issued ASU 2011-08, "Intangible – Goodwill and Other (Topic 350) – Testing Goodwill for Impairment." The amendments in this ASU permit an entity to first assess qualitative factors related to goodwill to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this ASU, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments in this ASU are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The Company is currently assessing the impact that ASU 2011-08 will have on its consolidated financial statements.

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

In December 2011, the FASB issued ASU 2011-12, "Comprehensive Income (Topic 220) – Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05." The amendments are being made to allow the Board time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the Board is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. All other requirements in ASU 2011-05 are not affected by ASU 2011-12, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities should apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. Nonpublic entities should begin applying these requirements for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. The Company is currently assessing the impact that ASU 2011-12 will have on its consolidated financial statements.

No other recent accounting pronouncements had a material impact on the Company's consolidated financial statements, and it is believed that none will have a material impact on the Company's operations in future years.

NOTE THREE: SECURITIES

The income derived from taxable and non-taxable securities for the years ended December 31, 2011 and 2010 is shown below (in thousands of dollars):

		Year Ended I	December	: 31,
	20	011		2010
Investment securities, taxable	\$	608	\$	625
Investment securities, non-taxable		50		106

The carrying amount and estimated fair value of securities available for sale at December 31, 2011 and 2010 are as follows (in thousands of dollars):

Available for Sale Securities

December 31, 2011	Amo	ortized Cost	U	Inrealized Gains	nrealized Losses	 Fair Value
U.S. Treasuries and Agencies	\$	21,741	\$	195	\$ 4	\$ 21,932
Mortgage backed securities		5,456		151	3	5,604
Collateralized mortgage obligations		3,387		37	11	3,413
State and municipals		2,642		56	0	2,698
Certificates of deposit		5,901		15	6	5,910
Total Securities Available for Sale	\$	39,127	\$	454	\$ 24	\$ 39,557
December 31, 2010						
					_	
U.S. Treasuries and Agencies	\$	9,132	\$	133	\$ 7	\$ 9,258
Mortgage backed securities		5,505		153	7	5,651
Collateralized mortgage obligations		1,764		0	0	1,764
State and municipals		2,123		34	0	2,157
Certificates of deposit		6,442		25	2	6,465
Marketable equities		15		14	0	29
Total Securities Available for Sale	\$	24,981	\$	359	\$ 16	\$ 25,324

The carrying amount and fair value of securities at December 31, 2011, by contractual maturity are shown below (in thousands of dollars). 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.

	Amort	ized Cost	Fai	r Value
Securities Available for Sale				
Due in next twelve months	\$	9,495	\$	9,572
Due after one year through five		20,788		20,968
Due beyond five years		3,388		3,413
Mortgage backed securities		5,456		5,604
Total Available For Sale	\$	39,127	\$	39,557

Securities having a carrying value of \$9,449,000 at December 31, 2011 and \$7,195,000 at December 31, 2010 were pledged to secure public deposits and for other purposes required by law.

Information pertaining to securities with gross unrealized losses at December 31, 2011 and 2010, aggregated by investment category and length of time that individual securities have been in a continuous loss position is shown in the table below (in thousands of dollars):

December 31, 2011	_ Fair	To Value	Unr	ross ealized osses	Fa	Less than	Uni	ns Gross ealized osses	_ Fai	12 Months	Un	ter Gross realized Losses
Investment Category	Φ.	2 40 4	Φ.	(4)	0	2.404	ė.	(4)	¢.	0	¢.	0
U.S. Treasuries and Agencies	2	2,494	\$	(4)	\$	2,494	\$	(4)	\$	0	\$	0
Mortgage backed securities		1,007		(3)		1,007		(3)		0		0
Collateralized mortgage obligations		904		(11)		904		(11)		0		0
Certificates of deposit		943		(6)		943		(6)		0		0
Total	\$	5,348	\$	(24)	\$	5,348	\$	(24)	\$	0	\$	0
December 31, 2010												
Investment Category												
U.S. Treasuries and Agencies	\$	993	\$	(7)	\$	993	\$	(7)	\$	0	\$	0
Mortgage backed securities		2,283		(7)		2,283		(7)		0		0
Collateralized mortgage obligations		827		0		827		O O				
Certificates of deposit		494		(2)		494		(2)		0		0
Total	\$	4,597	\$	(16)	\$	4,597	\$	(16)	\$	0	\$	0

The number of securities available for sale that were in an unrealized loss position at December 31, 2011 is summarized in the table below:

	Total	Loss Position less than 12 Months	Loss Position greater than 12 Months
U.S. Treasuries and Agencies	2	2	0
Mortgage backed securities	1	1	0
Collateralized mortgage obligations	1	1	0
Certificates of deposit	4	4	0
Total	8	8	0

It is management's determination that all securities held at December 31, 2011, which have fair values less than the amortized cost, have gross unrealized losses related to increases in the current interest rates for similar issues of securities, and that no material impairment for any securities in the portfolio exists because of downgrades of the securities or as a result of a change in the financial condition of any of the issuers.

NOTE FOUR: RESTRICTED INVESTMENTS

Restricted investments consist of investments in the Federal Home Loan Bank, the Federal Reserve Bank and West Virginia Bankers' Title Insurance Company. Investments are carried at face value and the level of investment is dictated by the level of participation with each institution. Amounts are restricted as to transferability. Investments in the Federal Home Loan Bank act as collateral against the outstanding borrowings from that institution.

NOTE FIVE: LOANS

Loans outstanding as of December 31, 2011 and 2010 are summarized as follows (in thousands of dollars):

	2011	2010
Commercial	\$ 101,51	7 \$ 97,089
Real Estate Construction	23,71	1 33,746
Real Estate Mortgage	162,21	4 168,226
Consumer Installment	25,61	4 30,275
Total Loans	\$ 313,05	\$ 329,336

Consumer Mortgage

The following is a summary of information pertaining to impaired loans by portfolio segment at December 31, 2011 and 2010 (in thousands of dollars):

Impaired Loans As of December 31, 2011

			ecorded vestment	P	Unpaid rincipal Balance		lated	R	Average lecorded vestment	In	terest come ognized
With no related allowance recorded:											
Commercial Mortgage		\$	21,160	\$	21,160	\$	0	\$	23,065	\$	1,287
Commercial Other			261		261		0		300		23
Consumer Mortgage			930		930		0		940		49
	Sub-total	\$	22,351	\$	22,351	\$	0	\$	24,305	\$	1,359
With an allowance recorded:		<u> </u>	 _			<u> </u>				_	,,,,,,
Commercial Mortgage			5,383		5,383		1,018		5,468		125
Commercial Other			430		430		167		475		23
Consumer Mortgage			1,036		1,036		328		1,036		42
	Sub-total	S	6,849	\$	6,849	\$	1,513	\$	6,979	\$	190
Total	Suo tour	Ψ	0,015	Ψ	0,012	Ψ	1,010	Ψ	0,272	Ψ	
Commercial Mortgage			26,543		26,543		1,018		28,534		1,412
Commercial Other			691		691		167		775		46
Consumer Mortgage			1,966		1,966		328		1,976		91
	Total	\$	29,200	\$	29,200	\$	1,513	\$	31,285	\$	1,549
			ed Loans nber 31, 201	0							
			ecorded vestment	P	Unpaid rincipal Balance		lated	R	Average lecorded vestment	In	terest come ognized
With no related allowance recorded:											
Commercial Mortgage		\$	18.455	\$	18.455	\$	0	\$	26.557	\$	137
Commercial Other		Ψ	840	Ψ	840	Ψ	0	Ψ	1.159	Ψ	13
Consumer Mortgage			253		253		0		256		2
consumer mongage	Sub-total	\$	19,548	\$	19,548	\$	0	\$	27,972	\$	152
With an allowance recorded:	Sub total	Ψ	17,510	Ψ	17,510	Ψ		Ψ	21,712	Ψ	132
Commercial Mortgage			5,692		5,692		904		6,871		272
Commercial Other			148		148		21		203		19
	Sub-total	S		S		\$		S	7 074	\$	
Total	Sub-total	\$	5,840	\$	5,840	\$	925	\$	7,074	\$	291
Total Commercial Mortgage	Sub-total	\$	5,840	\$	5,840	\$	925	\$		\$	291
Total Commercial Mortgage Commercial Other	Sub-total	\$		\$		\$		\$	7,074 33,428 1,362	\$	

No loans were identified as impaired with potential loss as of December 31, 2011 or December 31, 2010 for which an allowance was not provided. The table above includes troubled debt restructurings (TDR) of \$14,152,000 and \$5,607,000 as of December 31, 2011 and December 31, 2010, respectively. Loans are identified as TDR if concessions are made related to the terms of the loan beyond regular lending practices in response to a borrower's financial condition. Restructured loans performing in accordance with modified terms consist of twenty commercial mortgages and fifteen consumer mortgages. Restructured loans not performing in accordance with modified terms consist of six commercial mortgages and seven consumer mortgages. These loans were balloon renewals or restructurings of borrowers experiencing financial difficulties at either current market rates for borrowers not experiencing financial difficulties, were modified to reduce interest rates, or provide for interest-only payment periods. These loans did not have any additional commitments to extend credit at December 31, 2011.

Total

253

25,388

253 25,388

925

35,046

256

443

Balances of non-accrual loans at December 31, 2011 and December 31, 2010 are shown below (in thousands of dollars):

	Decembe	December 31, 2011				
Loans on non-accrual status						
Commercial Mortgage	\$	4,152	\$	2,215		
Commercial Other		295		139		
Consumer Mortgage		3,526		4,240		
Consumer Other		48		385		
Total non-accrual loans	\$	8,021	\$	6,979		

Certain loans identified as impaired are placed into non-accrual status, based upon the loan's performance compared with contractual terms. Not all loans identified as impaired are placed into non-accrual status. The interest on loans identified as impaired and placed into non-accrual status that was not recognized as income throughout the year (foregone interest) was \$396,000 and \$427,000 in 2011 and 2010, respectively.

The following table presents the contractual aging of the recorded investment in past due loans by class as of December 31, 2011 and December 31, 2010 (in thousands of dollars):

Age Analysis of Past Due Financing Receivables As of December 31, 2011

	-59 Days Past Due	0-89 Days Past Due	Greater Than 90 Days	7	Total Past Due	Current	Total Financing Leceivables	Recorded Investment > 90 Days and Accruing
Commercial - Mortgage	\$ 3,541	\$ 1,490	\$ 3,599	\$	8,630	\$ 130,744	\$ 139,374	\$ 212
Commercial -Other	313	27	297		637	13,072	13,709	11
Consumer - Mortgage	4,317	2,770	3,120		10,207	126,265	136,472	269
Consumer - Other	738	300	65		1,103	22,398	23,501	44
Total	\$ 8,909	\$ 4,587	\$ 7,081	\$	20,577	\$ 292,479	\$ 313,056	\$ 536

Age Analysis of Past Due Financing Receivables As of December 31, 2010

	-59 Days Past Due	0-89 Days Past Due	Greater Than 90 Days	7	Cotal Past Due	Current	Total Financing eceivables	Recorded Investment > 90 Days and Accruing
Commercial - Mortgage	\$ 3,691	\$ 663	\$ 2,188	\$	6,542	\$ 136,354	\$ 142,896	\$ 301
Commercial -Other	234	396	46		676	14,361	15,037	46
Consumer - Mortgage	5,391	2,952	4,089		12,432	130,073	142,505	397
Consumer - Other	917	580	171		1,668	27,230	28,898	122
Total	\$ 10,233	\$ 4,591	\$ 6,494	\$	21,318	\$ 308,018	\$ 329,336	\$ 866

Troubled Debt Restructurings:

The following tables present the Company's loans restructured during the twelve month reporting period ending December 31, 2011 considered troubled debt restructuring by loan type (in thousands of dollars except number of contracts):

		For the two		Debt Restructurings period ended Decemb	er 31 2011	
		Number of Contacts	Pre Outsta	-Modification anding Recorded Investment	Post- Outstar	-Modification nding Recorded nvestment
Troubled Debt Restructurings						
Commercial Mortgage		20	\$	12,039	\$	11,874
Commercial Other		3		469		466
Consumer Mortgage		9		1,569		1,595
	Total	32	\$	14,077	\$	13,935

The following table presents the Company's restructured loans for which there was a payment default during the twelve month reporting period ended December 31, 2011:

				ubled Debt Restructu period ended Decem	
		Number of Contacts	Reco	orded Investment	rance associated Defaulted TDR's
Troubled debt restructurings:					
Commercial Mortgage		5	\$	1,826	\$ 405
Commercial Other		4		431	85
Consumer Mortgage		7		641	 62
	Total	16	\$	2,898	\$ 552

NOTE SIX: EARNINGS PER SHARE

Earnings per share represents income available to common stockholders divided by the weighted average number of common shares outstanding during the period. During 2011 and 2010, there were no changes to the outstanding shares of common stock.

NOTE SEVEN: ALLOWANCE FOR LOAN LOSSES

A summary of the changes in the allowance for loan losses for the years ended December 31, 2011 and 2010 is shown below (in thousands of dollars):

	201	1	2010
Balance at beginning of year	\$	5,407 \$	4,021
Provision charged to operating expenses		3,624	3,487
Loan recoveries		502	646
Loans charged off		(3,422)	(2,747)
Balance at end of year	\$	6,111 \$	5,407
Allowance for Loan Losses as percentage of outstanding loans at year end		1.95%	1.64%

Allowance for Credit Losses and Recorded Investment in Financing Receivables For the Year Ended December 31, 2011

		ommercial Mortgage	Co	ommercial Other	onsumer Aortgage	Consumer Other	Ur	nallocated	Total
Allowance for Credit Losses:									
Beginning Balance 12/31/2010	\$	1,345	\$	887	\$ 1,662	\$ 968	\$	545	\$ 5,407
Charge-off	S	2,322		163	565	372		0	3,422
Recoverie	S	129		137	15	221		0	502
Provision	1	3,746		(396)	847	(389)		(184)	3,624
Ending Balance 12/31/2011	\$	2,898	\$	465	\$ 1,959	\$ 428	\$	361	\$ 6,111
Ending Balance: individually evaluated for impairment		1,018		167	328	0		0	1,513
Ending Balance: collectively evaluated for impairment		1,880		298	1,631	428		361	4,598
Financing Receivables:									
Ending Balance		139,374		13,709	136,472	23,501		0	313,056
Ending Balance: individually evaluated for impairment		26,543		691	1,966	0		0	29,200
Ending Balance: collectively evaluated for impairment	\$	112,831	\$	13,018	\$ 134,506	\$ 23,501	\$	0	\$ 283,856
				44					

Allowance for Credit Losses and Recorded Investment in Financing Receivables For the Year Ended December 31, 2010

	ommercial Aortgage	 mmercial Other	-	onsumer Iortgage	-	onsumer Other	Un	allocated	Total
Allowance for Credit Losses:									
Ending Balance 12/31/2010	\$ 1,345	\$ 887	\$	1,662	\$	968	\$	545	\$ 5,407
Ending Balance: individually evaluated for impairment	904	21		0		0		0	925
Ending Balance: collectively evaluated for impairment	441	866		1,662		968		545	4,482
Financing Receivables:									
Ending Balance	142,896	15,037		142,505		28,898		0	329,336
Ending Balance: individually evaluated for impairment	24,147	988		253		0		0	25,388
Ending Balance: collectively evaluated for impairment	\$ 118,749	\$ 14,049	\$	142,252	\$	28,898	\$	0	\$ 303,948
		·		•					
		45							

The following table presents the Company's loans by internally assigned grades and by loan type for the years ended December 31, 2011 and 2010 (in thousands of dollars).

Credit Quality Indicators As of December 31, 2011

Credit Risk Profile by Internally Assigned Grade

Grade:		ommercial Mortgage	С	ommercial Other	Consumer Mortgage	•	Consumer Other	Total
	Excellent	\$ 732	\$	1,400	\$ 2,437	\$	2,740	\$ 7,309
	Very Good	14,049		607	28,026		4,128	46,810
	Pass	70,462		9,693	88,752		14,942	183,849
	Pass-Watch	12,050		117	1,106		104	13,377
	Special Mention	13,887		1,107	5,449		1,016	21,459
	Substandard	28,161		785	9,849		571	39,366
	Doubtful	33		0	853		0	886
	Loss	0		0	0		0	0
Total		\$ 139,374	\$	13,709	\$ 136,472	\$	23,501	\$ 313,056

Credit Quality Indicators As of December 31, 2010

Credit Risk Profile by Internally Assigned Grade

Grade:		ommercial Mortgage	Co	Other	Consumer Mortgage	(Consumer Other	Total
	Excellent	\$ 1,573	\$	968	\$ 2,964	\$	2,793	\$ 8,298
	Very Good	16,509		1,648	28,611		5,765	52,533
	Pass	90,198		8,901	96,776		18,244	214,119
	Pass-Watch	3,160		619	1,228		120	5,127
	Special Mention	7,262		1,876	6,050		1,526	16,714
	Substandard	24,194		1,025	6,747		450	32,416
	Doubtful	0		0	0		0	0
	Loss	 0		0	 129		0	 129
Total		\$ 142,896	\$	15,037	\$ 142,505	\$	28,898	\$ 329,336

Loans classified as, "special mention" have potential weaknesses that deserve management's close attention. Loans classified as "substandard" have been determined to be inadequately protected by the current collateral pledged, if any, the cash flow and or the net worth of the borrower. "Doubtful" loans have all the weaknesses inherent in substandard loans, 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 classified as "loss" are loans with expected loss of the entire principal balance. The loan may be carried in this classified status if circumstances indicate a remote possibility that the amount will be repaid, however, the principal balance is included in the impairment calculation and carried in the allowance for loan losses. Loans not categorized as special mention, substandard, or doubtful are classified as "pass", "very good" or "excellent" loans and are considered to exhibit acceptable risk. Additionally the company classifies certain loans as "pass-watch" loans. This category includes satisfactory borrowing relationships that require close monitoring because of complexity, information deficiencies, or emerging signs of weakness.

NOTE EIGHT: BANK PREMISES AND EQUIPMENT

Bank premises and equipment as of December 31, 2011 and 2010 are summarized as follows (in thousands of dollars):

	2011	2010
Land	\$ 2,368	\$ 2,237
Buildings and improvements	9,308	9,445
Furniture and equipment	 5,942	 5,805
Total Cost	17,618	17,487
Less accumulated depreciation	 (8,207)	 (7,586)
Net Book Value	\$ 9,411	\$ 9,901

Provisions for depreciation charged to operations during 2011 and 2010 were as follows (in thousands of dollars):

<u>Year</u>	Provision for Depreciation
2011	\$ 783
2010	787

NOTE NINE: RESTRICTIONS ON DIVIDENDS OF SUBSIDIARY BANKS

The principal source of funds of the Company is dividends paid by its subsidiary Banks. The various regulatory authorities impose restrictions on dividends paid by a state bank. A state bank cannot pay dividends (without the consent of state banking authorities) in excess of the total net profits (net income less dividends paid) of the current year to date and the combined retained profits of the previous two years. As of December 31, 2011, the Banks could pay dividends to the Company of approximately \$3,307,000 without permission of the regulatory authorities.

NOTE TEN: DEPOSITS

At December 31, 2011, the scheduled maturities of time deposits were as follows (in thousands of dollars):

	Amount
Year	 Maturing
2012	\$ 119,283
2013	34,409
2014	11,569
2015	9,979
2016	24,187
2017	20
Total	\$ 199,447

Included in the table above are CDARS deposits totaling \$3,393,000 at December 31, 2011.

Interest expense on time deposits of \$100,000 and over aggregated \$1,515,000 and \$2,020,000 for 2011 and 2010, respectively.

The aggregate amount of demand deposit overdrafts reclassified as loan balances were \$180,000 and \$214,000 at December 31, 2011 and 2010, respectively.

NOTE ELEVEN: CONCENTRATIONS

The Banks grant commercial, residential real estate and consumer loans to customers located primarily in the eastern portion of the State of West Virginia. Although the Banks have a diversified loan portfolio, a substantial portion of the debtors' ability to honor their contracts is dependent upon the agribusiness, mining, trucking and logging sectors. Collateral required by the Banks is determined on an individual basis depending on the purpose of the loan and the financial condition of the borrower. The ultimate collectability of the loan portfolios is susceptible to changes in local economic conditions. Of the \$313,056,000 and \$329,336,000 loans held by the Company at December 31, 2011 and 2010, respectively, \$273,785,000 and \$282,882,000 are secured by real estate.

The Company's subsidiaries had cash deposited in and federal funds sold to other commercial banks totaling \$13,582,000 and \$9,368,000 at December 31, 2011 and 2010, respectively. Deposits with other correspondent banks are generally unsecured and have limited insurance under current banking insurance regulations, which management considers to be a normal business risk

NOTE TWELVE: TRANSACTIONS WITH RELATED PARTIES

During the year, officers and directors (and companies controlled by them) of the Company and subsidiary Banks were customers of and had transactions with the subsidiary Banks in the normal course of business. These transactions were made on substantially the same terms as those prevailing for other customers and did not involve any abnormal risk. The table below summarizes changes to balances of loans and to unused commitments to related parties during the years ended December 31, 2011 and 2010 (in thousands of dollars):

	2011	2010
Loans to related parties, beginning of year	\$ 8,677	\$ 8,402
New loans	9	798
Additions for new executives	0	257
Deletions for former executives	(1,509)	0
Repayments	 (538)	 (780)
Loans to related parties, end of year	\$ 6,639	\$ 8,677

At December 31, 2011, deposits of related parties including directors, executive officers, and their related interests of the Company and subsidiaries approximated \$7,163,000, and at December 31, 2010, deposits of related parties including directors, executive officers, and their related interests of the Company and subsidiaries approximated \$8,349,000.

NOTE THIRTEEN: DEBT INSTRUMENTS

The Company has borrowed money from the Federal Home Loan Bank of Pittsburgh (FHLB). This debt consists of both borrowings with terms of maturities of six months or greater and also certain debts with maturities of thirty days or less.

The borrowings with long term maturities may have either single payment maturities or amortize. The various borrowings mature from 2012 to 2020. The interest rates on the various borrowings at December 31, 2011 range from 1.68% to 5.96%. The weighted average interest rate on the borrowings at December 31, 2011 was 3.76%. Repayments of long-term debt are due monthly, quarterly or in a single payment at maturity. The maturities of long-term debt as of December 31, 2011 are as follows (in thousands of dollars):

Year	 Balance
<u>Year</u> 2012	\$ 5,597
2013	351
2014	603
2015	0
2016	4,544
Thereafter	 150
Total	\$ 11,245

In addition to utilization of the FHLB for borrowings of long term debt, the Company also can utilize the FHLB for overnight and other short term borrowings; however, at December 31, 2011, the Company had no balances in overnight and other short term borrowings. The Company has total borrowing capacity from the FHLB of \$73,394,000. The Banks have pledged mortgage loans and securities as collateral on the FHLB borrowings in the approximate amount of \$73,394,000 at December 31, 2011.

The subsidiary Banks also have short term borrowing capacity from each of their respective correspondent banks. As of December 31, 2011 the Company has total borrowing capacity from its correspondent banks of \$13,500,000. The interest rates on these lines are variable and are subject to change daily based on current market conditions. There were no borrowings outstanding on these lines as of December 31, 2011 or 2010.

NOTE FOURTEEN: INCOME TAX EXPENSE

The Company files an income tax return in the U.S. federal jurisdiction and an income tax return in the State of West Virginia. With few exceptions, the Company is no longer subject to U.S. federal, state or local income tax examinations by tax authorities for years before 2008.

Included in the balance sheet at December 31, 2011 are tax positions related to loan charge offs for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

The components of income tax expense for the years ended December 31, 2011 and 2010 are summarized in the table on the following page (in thousands of dollars):

	2011		2010	
Current Expense				
Federal	\$	988	\$	984
State		126		139
Total Current Expense		1,114		1,123
Deferred Expense (Benefit)				
Federal		(526)		(444)
State		(50)		(39)
Total Deferred Expense (Benefit)		(576)		(483)
Income Tax Expense	\$	538	\$	640
The deferred tax effects of temporary differences for the years ended December 31, 2011 and 2010 are as follows (in thousands of dollars):				
		2011		2010
Provision for loan losses	\$	(122)	\$	(519)
OREO deferred costs		(403)		0
Pension Expense		(35)		(91)
Depreciation		(33)		183
Deferred compensation		27		(62)
Miscellaneous		(10)		6
Net increase in deferred income tax benefit	\$	(576)	\$	(483)

The net deferred tax assets arising from temporary differences as of December 31, 2011 and 2010 are shown in the table on the following page (in thousands of dollars):

	2011	2010
Deferred Tax Assets	 	
Provision for loan losses	\$ 1,846	\$ 1,725
OREO deferred expenses	401	0
Insurance commissions	15	19
Deferred compensation	957	983
Pension obligation	994	641
Other	 10	 2
Total Assets	4,223	3,370
Deferred Tax Liabilities		
Unrealized gains on securities available for sale	159	125
Depreciation	595	638
Other	 1	 2
Total Liabilities	755	765
Net Deferred Tax Asset	\$ 3,468	\$ 2,605

The Company has not recorded a valuation allowance for the deferred tax assets as management believes it is more likely than not that they will be ultimately realized.

The following table summarizes the differences between income tax expense and the amount computed by applying the federal statutory rate for the two years ended December 31, 2011 and 2010 (in thousands of dollars):

	2	011	2	010
Amounts at federal statutory rate	\$	656	\$	759
Additions (reductions) resulting from:				
Tax exempt income		(38)		(59)
Partially exempt income		(19)		(26)
State income taxes, net		60		28
Income from life insurance contracts		(128)		(43)
Non deductible expenses related to branch acquisitions		54		53
Income tax credits		(37)		0
Other		(10)		(72)
Income tax expense	\$	538	\$	640

NOTE FIFTEEN: EMPLOYEE BENEFITS

In addition to an Employee Stock Ownership Plan (ESOP), which provides stock ownership to all employees of the Company, the Company's two subsidiary Banks, The Grant County Bank (Grant) and Capon Valley Bank (Capon) have separate retirement and profit sharing plans which cover substantially all full time employees at each Bank. A summary of the employee benefits provided by each Bank is provided below. The Company's ESOP plan provides stock ownership to all employees of the Company. The Plan provides total vesting upon the attainment of seven years of service. Contributions to the plan are made at the discretion of the board of directors and are allocated based on the compensation of each employee relative to total compensation paid by the Company. All shares held by the Plan are considered outstanding in the computation of earnings per share. Shares of Company stock, when distributed, will have restrictions on transferability. Certain executives of both Grant and Capon have post retirement benefits related to the Banks' investment in life insurance policies (see Note Nineteen). Expenses related to all retirement benefit plans charged to operations totaled \$649,000 in 2011 and \$976,000 in 2010.

Capon Valley Bank

Capon has a defined contribution pension plan with 401(k) features that is funded with discretionary contributions. Capon matches on a limited basis the contributions of the employees. Investment of employee balances is done through the direction of each employee. Employer contributions are vested over a six-year period.

The Grant County Bank

Grant is a member of the West Virginia Bankers' Association Retirement Plan (the "Plan"). This Plan is a defined benefit plan with benefits under the Plan based on compensation and years of service with full vesting after seven years of service. Prior to 2002, the Plan's assets were in excess of the projected benefit obligations and thus Grant was not required to make contributions to the Plan during 2001, 2002, or 2003. Beginning 2004, Grant has been required to make contributions. The contribution expected during 2012 is \$1,451,000. At December 31, 2011, Grant has recognized liabilities of \$2,715,000 relating to unfunded pension liabilities. As a result of the Plan's inability to meet expected returns in recent years, a portion of this liability is reflected as a decrease in other comprehensive income of \$2,025,000 (net of \$1,190,000 tax benefit).

The following table provides a reconciliation of the changes in the Plan's obligations and fair value of assets as of December 31, 2011 and 2010 using a measurement date of December 31, 2011 and December 31, 2010 respectively (in thousands of dollars):

		2011		2010
Change in Benefit Obligation	ø	(011	\$	5 126
Benefit obligation, beginning Service Cost	\$	6,011 204	Э	5,136 188
Service Cost Interest Cost		325		303
niciest Coss (Gain)		472		464
Renefits Paid		(160)		(80)
	\$	6,852	\$	6,011
Benefit obligation, ending	Ψ	0,032	Ψ	0,011
Accumulated Benefit Obligation	\$	5,830	\$	5,037
Change in Plan Assets				
Fair value of assets, beginning	\$	4,249	\$	3,858
Actual return on assets, net of administrative expenses		(187)		471
Employer contributions		235		0
Benefits paid		(160)		(80)
Fair value of assets, ending	\$	4,137	\$	4,249
Funded Status				
Fair value of plan assets	\$	4,137	\$	4,249
Projected benefit obligation		6,852		6,011
Funded status		(2,715)		(1,762)
Amounts Recognized in the Statements of Financial Position				
Accumulated other comprehensive loss	\$	3,215	\$	2,356
(Prepaid) pension expense		(500)		(594)
Net liability recognized	\$	2,715	\$	1,762
Amounts Recognized in Accumulated Other Comprehensive Income				
Unrecognized actuarial loss	\$	3,215	\$	2,356
52				

The following table provides the components of the net periodic pension expense for the Plan for the years ended December 31, 2011 and 2010 (in thousands of dollars):

	2	011	2	010
Service cost	\$	204	\$	188
Interest cost		325		303
Expected return on plan assets		(353)		(337)
Recognized net actuarial loss		154		98
Net Periodic Pension Expense	\$	330	\$	252

The expected pension expense for 2012 is \$282,000. The amount of estimated loss accumulated in other comprehensive income expected to be recognized in net periodic benefit cost in 2012 is \$207,000.

The table below summarizes the benefits expected to be paid to participants in the plan (in thousands of dollars):

		Expected Benefit
Year		Payments
2012	S	272
2013		306
2014		356
2015		370
2016		386
Years 2017 – 2021		2.077

The weighted average assumption used in the measurement of Grant's benefit obligation and net periodic pension expense is as follows:

	2011	2010
Discount rate	5.50%	6.00%
Expected return on plan assets	8.00%	8.00%
Rate of compensation increase	3.00%	3.00%

The plan sponsor estimates the expected long-term rate of return on assets in consultation with their advisors and the plan actuary. This rate is intended to reflect the average rate of earnings expected to be earned on the funds invested or to be invested to provide plan benefits. Historical performance is reviewed, especially with respect to real rate of return (net of inflation) for the major asset classes held or anticipated to be held by the trust. Undue weight is not given to recent experience, which may not continue over the measurement period, with higher significance placed on current forecasts of future long-term economic conditions.

The following table provides the pension plan's asset allocation as of December 31, 2011 and 2010:

	2011	2010
Equity Securities	60%	59%
Debt Securities	35%	31%
Other	5%	10%

The trust fund is sufficiently diversified to maintain a reasonable level of risk without imprudently sacrificing return. The targeted asset allocation and allowable range of allocation is set forth in the table below:

	Target Allocation	Allowable Allocation Range
Equity Securities	70%	40%-80%
Debt Securities	25%	20%-40%
Other	5%	3%-10%

The Investment Manager selects investment fund managers with demonstrated experience and expertise, and funds with demonstrated historical performance, for the implementation of the Plan's investment strategy. The Investment Manager will consider both actively and passively managed investment strategies and will allocate funds across the asset classes to develop an efficient investment structure.

Fair Value

Totals

The fair value of the Company's pension plan assets at December 31, 2011 and 2010, by asset category is as follows:

		, ,	Fair Va	lue Measurements Usin	g		
		Balance as of December 31,		In Active Markets for Identical Assets		Significant Other Observable Inputs	Significant Unobservable Inputs
Asset Category		2011		(Level 1)		(Level 2)	(Level 3)
Cash and cash equivalents	\$	17	\$	17	\$	0	\$ 0
Equity securities:							
U.S. Companies		1,930		1,930			
International Companies		556		556			
Debt Securities		1,451				1,451	
Short Term		183		183			
Totals	\$	4,137	\$	2,686	\$	1,451	\$ 0
	_		Fair Va	lue Measurements Usin Quoted Prices In Active	g		
				Markets		Significant	
		Balance		for		Other	Significant
		as of		Identical		Observable	Unobservable
		December 31,		Assets		Inputs	Inputs
Asset Category		2010		(Level 1)		(Level 2)	 (Level 3)
Cash and cash equivalents	\$	404	\$	404	\$	0	\$ 0
Equity securities:							
U.S. Companies		1,870		1,870			
International Companies		442		442			
Debt Securities		1,313				1,313	
Short Term		220		220			

1,313

The Grant County Bank also maintains a profit sharing plan covering substantially all employees to which contributions are made at the discretion of the board of directors. Portions of employer contributions to this plan are, at individual employees' discretion, available to employees as immediate cash payment while portions are allocated for deferred payment to the employee are vested over a five year period.

NOTE SIXTEEN: COMMITMENTS AND GUARANTEES

The Banks make commitments to extend credit in the normal course of business and issue standby letters of credit to meet the financing needs of their customers. The amount of the commitments represents the Banks' exposure to credit loss that is not included in the balance sheet.

The Banks use the same credit policies in making commitments and issuing letters of credit as used for the loans reflected in the balance sheet. 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 Banks evaluate each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Banks upon the extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but may include accounts receivable, inventory, property, plant and equipment.

As of December 31, 2011 and 2010, the Banks had outstanding the following commitments (in thousands of dollars):

	2011	2010		
Commitments to extend credit	\$ 10,036	\$	11,138	
Standby letter of credit	352		342	

NOTE SEVENTEEN: CHANGES IN OTHER COMPREHENSIVE INCOME

The components of changes in other comprehensive income, net of deferred tax, for the years ended December 31, 2011 and 2010 are as follows (in thousands of dollars):

	Unre	alized			
	Gains(1	osses) on	Defir	ned Benefit	
		ırities	Plan	Obligation	Total
Balance, December 31, 2009	\$	323	\$	(1,338)	\$ (1,015)
2010 change		(110)		(146)	 (256)
Balance, December 31, 2010		213		(1,484)	(1,271)
2011 change		56		(540)	 (484)
Balance, December 31, 2011	\$	269	\$	(2,024)	\$ (1,755)

NOTE EIGHTEEN: FAIR VALUE MEASUREMENTS

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the authoritative accounting guidance regarding fair value measurements and disclosures, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based on quoted market prices. However, in the event there are no quoted market prices available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

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

ASC 820, Fair Value Measurements and Disclosures, defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- <u>Level One:</u> Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- <u>Level Two</u>: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level Three: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Following is a description of the valuation methodologies used for instruments measured at fair value on the Company's balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy:

Securities |

Where quoted prices are available in an active market, securities are classified within level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Level 2 securities would include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within level 3 of the valuation hierarchy. Currently, all of the Company's securities are considered to be Level 2 securities.

Impaired Loans

The fair value measurement guidance applies to loans measured for impairment using the practical expedients permitted by authoritative accounting guidance, including impaired loans measured at an observable market price (if available), or at the fair value of the loan's collateral (if the loan is collateral dependent). Fair value of the loan's collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the estimated cost related to liquidation of the collateral. Fair value of collateral dependent loans are considered level two if the most recent appraisal or independent valuation is complete within the preceding twelve months. Fair value of collateral dependent loans are considered level three if the most recent appraisal or independent valuation is over twelve months old. At December 31, 2011, the Company had impaired loans of \$29,200,000 of which \$6,849,000 required an allowance of \$1,513,000. (see Note Five).

Other Real Estate Owned

Certain assets such as other real estate owned (OREO) are measured at fair value. Real estate acquired through foreclosure is recorded at an estimated fair value less cost to sell. At or near the time of foreclosure, a real estate appraisal is obtained on the properties. The real estate is then valued at the lesser of the appraised value or the loan balance, including interest receivable, at the time of foreclosure less an estimate of costs to sell the property. Appraised values are typically determined utilizing an income or market valuation approach based on an appraisal conducted by an independent, licensed appraiser (Level 2). If the acquired property is a house or building in the process of construction or if an appraisal of the real estate property is over twelve months old, the fair value is considered Level 3. The estimate of costs to sell the property is based on historical transactions of similar holdings.

The Company, at December 31, 2011, had no liabilities subject to fair value reporting requirements. The tables below summarize assets at December 31, 2011 and 2010 measured at fair value on a recurring basis (in thousands of dollars):

T-4-1 E-2-

D 1 21 2011	т.	1.1	T 12	T 12		Value
<u>December 31, 2011</u>	Le	evel 1	 Level 2	 Level 3	Me	asurements
U.S. Treasuries and Agencies	\$	0	\$ 21,932	\$ 0	\$	21,932
Mortgage backed securities		0	5,604	0		5,604
Collateralized mortgage obligations		0	3,413	0		3,413
States and municipalities		0	2,698	0		2,698
Certificates of deposit		0	5,910	0		5,910
Total Available For Sale Securities	\$	0	\$ 39,557	\$ 0	\$	39,557
December 31, 2010	Le	evel 1	 Level 2	 Level 3		Ootal Fair Value asurements
U.S. Treasuries and Agencies	Le \$	evel 1	\$ Level 2 9,258	\$ Level 3		Value
U.S. Treasuries and Agencies Mortgage backed securities	Le \$	evel 1 0 0	\$ 	\$ 		Value asurements
U.S. Treasuries and Agencies	Le \$	0 0 0	\$ 9,258	\$ 		Value asurements 9,258
U.S. Treasuries and Agencies Mortgage backed securities	Le \$	0 0 0 0	\$ 9,258 5,651	\$ 		Value asurements 9,258 5,651
U.S. Treasuries and Agencies Mortgage backed securities Collateralized mortgage obligations States and municipalities Certificates of deposit	Le \$	0 0 0 0 0	\$ 9,258 5,651 1,764	\$ 		Value asurements 9,258 5,651 1,764
U.S. Treasuries and Agencies Mortgage backed securities Collateralized mortgage obligations States and municipalities	<u>Le</u>	0 0 0 0	\$ 9,258 5,651 1,764 2,157	\$ 0 0 0 0		Value asurements 9,258 5,651 1,764 2,157

The tables below summarize assets at December 31, 2011 and 2010 measured at fair value on a non-recurring basis (in thousands of dollars):

	Level 1		Level 2 Le			Level 3		otal Fair Value surements	Twelve Months Ended December 31, 2011 Total gains/(losses)		
Other real estate owned	\$	0	\$	5,862	\$	1,208	\$	7,070	\$	(912)	
Impaired Loans		0		4,771		565		5,336		0	
Total	\$	0	\$	10,633	\$	1,773	\$	12,406	\$	(912)	
	I e	evel 1		Level 2		Level 3		otal Fair Value surements	Decer	Months Ended mber 31, 2010 Gains/(Losses)	
Other real estate owned	\$	0	\$	1,042	\$	3,658	S	4,700	S	(88)	
Impaired Loans	\$	0	\$	0	\$	4,915	\$	4,915	Š	0	
Total	6	0	•	1,042	0	8,573	Φ.	9,615	0	(88)	

The information above discusses financial instruments carried on the Company's balance sheet at fair value. Other financial instruments on the Company's balance sheet, while not carried at fair value, do have market values which may differ from the carrying value. The following information shows the carrying values and estimated fair values of financial instruments and discusses the methods and assumptions used in determining these fair values.

The fair value of the Company's assets and liabilities is influenced heavily by market conditions. Fair value applies to both assets and liabilities, either on or off the balance sheet. Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

The methods and assumptions detailed below were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value.

<u>Cash, Due from Banks and Money Market Investments</u>
The carrying amount of cash, due from bank balances, interest bearing deposits and federal funds sold is a reasonable estimate of fair value.

Securities

Fair values of securities are based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

The carrying amount of restricted investments is a reasonable estimate of fair value, and considers the limited marketability of such securities.

Loans
The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, taking into consideration the credit risk in various loan categories.

Deposits

The fair value of demand, interest checking, regular savings and money market deposits is the amount payable on demand at the reporting date. The fair value of fixed maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

<u>Long-Term Debt Instruments</u>
The fair value of fixed rate loans is estimated using the rates currently offered by the Federal Home Loan Bank for indebtedness with similar maturities.

<u>Interest Payable and Receivable</u>
The carrying values of interest receivable and payable are reasonable estimates of fair value.

The carrying amount of life insurance contracts is assumed to be a reasonable fair value. Life insurance contracts are carried on the balance sheet at their redemption value as of December 31, 2011 and 2010. This redemption value is based on existing market conditions and therefore represents the fair value of the contract.

Off-Balance-Sheet Items
The carrying amount and estimated fair value of off-balance-sheet items were not material at December 31, 2011 or 2010.

The carrying amount and estimated fair values of financial instruments as of December 31, 2011 and 2010 are shown in the table below (in thousands of dollars):

	December 31, 2011		December		: 31, 2010		
		Carrying Amount	stimated air Value		Carrying Amount		Estimated Fair Value
Financial Assets:							
Cash and due from banks	\$	9,321	\$ 9,321	\$	8,282	\$	8,282
Interest bearing deposits		2,329	2,329		3,532		3,532
Federal funds sold		11,253	11,253		5,836		5,836
Securities available for sale		39,557	39,557		25,324		25,324
Restricted investments		1,741	1,741		2,087		2,087
Loans, net		306,945	307,629		323,929		324,780
Interest receivable		1,513	1,513		1,791		1,791
Life insurance contracts		7,300	7,300		7,031		7,031
Financial Liabilities:							
Demand and savings deposits		144,625	144,625		132,085		132,085
Time deposits		199,447	201,074		210,727		211,590
Long term debt instruments		11,245	11,667		9,393		10,142
Interest payable		359	359		488		488

NOTE NINETEEN: INVESTMENTS IN LIFE INSURANCE CONTRACTS

Investments in insurance contracts consist of single premium insurance contracts, which have the purpose of providing a rate of return to the Company and providing a source of funding for retirement benefits to certain executives.

A summary of the changes to the balance of investments in insurance contracts for the twelve month periods ended December 31, 2011 and December 31, 2010 are shown in the table below (in thousands of dollars):

	2011	2010
Balance, beginning of period	\$ 7,031	\$ 6,755
Increases in value of policies	269	276
Balance, end of period	\$ 7,300	\$ 7,031

NOTE TWENTY: REGULATORY MATTERS

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

Quantitative measures established by regulation to ensure capital adequacy require the Company 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). The Company meets all capital adequacy requirements to which it is subject and as of the most recent examination, the Company was classified as well capitalized.

To be categorized as well capitalized the Company must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events that management believes have changed the Company's category from a well-capitalized status.

Capital ratios and amounts are applicable both at the individual Bank level and on a consolidated basis. At December 31, 2011 both subsidiary Banks had capital levels in excess of minimum requirements.

In addition, HBI Life Insurance Company is subject to certain capital requirements and dividend restrictions. At present, HBI Life is well within any capital limitations and no conditions or events have occurred to change this capital status, nor does management expect any such occurrence in the foreseeable future.

The actual and required capital amounts and ratios of the Company and its subsidiary banks at December 31, 2011 are presented in the following table (in thousands of dollars):

December 31, 2011

			,			Regulatory Re	equire	ements		
		Actua	.1		Adequately Capitalized			Well Capitalized		
	_	Amount	Percentage	_	Amount	Percentage	_	Amount	Percentage	
Total Risk Based Capital Ratio										
Highlands Bankshares	\$	44,970	15.17%	\$	23,715	8.00%				
Capon Valley Bank		14,619	13.16%		8,887	8.00%	\$	11,109	10.00%	
The Grant County Bank		28,172	15.31%		14,721	8.00%		18,401	10.00%	
Tier 1 Leverage Ratio										
Highlands Bankshares		41,235	10.22%		16,139	4.00%				
Capon Valley Bank		13,219	8.50%		6,221	4.00%		7,776	5.00%	
The Grant County Bank		25,874	10.55%		9,810	4.00%		12,262	5.00%	
Tier 1 Risk Based Capital Ratio										
Highlands Bankshares		41,235	13.91%		11,858	4.00%				
Capon Valley Bank		13,219	11.90%		4,443	4.00%		6,665	6.00%	
The Grant County Bank		25,874	14.06%		7,361	4.00%		11,042	6.00%	

The actual and required capital amounts and ratios of the Company and its subsidiary banks at December 31, 2010 are presented in the following table (in thousands of dollars):

December	21	2010

		Regulatory Requirements							
		Actu	ıal		Adequately (Capitalized	•	Well Cap	oitalized
	_	Amount	Percentage		Amount	Percentage	_	Amount	Percentage
Total Risk Based Capital Ratio									
Highlands Bankshares	\$	44,086	14.49%	\$	24,340	8.00%			
Capon Valley Bank		14,496	12.50%		9,277	8.00%	\$	11,597	10.00%
The Grant County Bank		27,306	14.58%		14,983	8.00%		18,728	10.00%
Tier 1 Leverage Ratio									
Highlands Bankshares		40,275	9.91%		16,256	4.00%			
Capon Valley Bank		13,029	8.33%		6,256	4.00%		7,821	5.00%
The Grant County Bank		24,953	10.26%		9,728	4.00%		12,160	5.00%
<u>Tier 1 Risk Based Capital Ratio</u>									
Highlands Bankshares		40,275	13.24%		12,168	4.00%			
Capon Valley Bank		13,029	11.24%		4,637	4.00%		6,955	6.00%
The Grant County Bank		24,953	13.32%		7,493	4.00%		11,240	6.00%

NOTE TWENTY ONE: INTANGIBLE ASSETS

The Company's balance sheet contains several components of intangible assets. At December 31, 2011, the total balance of intangible assets was comprised of Goodwill and Core Deposit Intangible Assets acquired as a result of the acquisition of other banks and also an intangible asset related to the purchased naming rights for a performing arts center located within the Company's primary business area.

A summary of the changes in balances of intangible assets for the twelve month periods ended December 31, 2011 and 2010 are shown below (in thousands of dollars):

	2011	2010
Balance beginning of period	\$ 2,364	\$ 2,554
Additional intangible assets	17	0
Amortization of intangible assets	(187)	(190)
Balance end of period	\$ 2,194	\$ 2,364

The expected amortization of the intangible balances at December 31, 2011 for the next five years is summarized in the table below (in thousands of dollars):

	Expected
<u>Year</u>	Expense
<u>Year</u> 2012 2013	182
2013	169
2014	168
2015	140
2016	1
Total	\$ 660

NOTE TWENTY TWO: SUBSEQUENT EVENTS

The Company evaluates subsequent events that have occurred after the balance sheet, but before the financial statements are issued. There are two types of subsequent events: (1) recognized, or those that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements, and (2) non-recognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

Based on management's evaluation through the date these financial statements were issued, the Company did not identify any recognized or non-recognized subsequent events that would have required adjustment or disclosure in the consolidated financial statements.

NOTE TWENTY THREE: PARENT COMPANY FINANCIAL STATEMENTS

Balance Sheets (in thousands of dollars)

		Decen	nber 31,		
		2011		2010	
Assets					
Cash	\$	13	\$	70	
Investment in subsidiaries		41,443		41,105	
Receivable from subsidiaries		397		267	
Fixed assets, net of accumulated depreciation		35		47	
Other assets		1		18	
Total Assets	\$	41,889	\$	41,507	
Liabilities					
Accrued expenses	\$	29	\$	53	
Income taxes payable		186		86	
Total Liabilities		215		139	
Stockholders' Equity					
Common stock, par value \$5 per share, 3,000,000 shares authorized, 1,436,874 issued		7,184		7,184	
Surplus		1,662		1,662	
Treasury stock, at cost, 100,001 shares		(3,372)		(3,372)	
Retained earnings		37,955		37,165	
Other accumulated comprehensive income (loss)		(1,755)		(1,271)	
Total Stockholders' Equity	·	41,674		41,368	
Total Liabilities and Stockholders' Equity	\$	41,889	\$	41,507	
					

Statements of Income and Retained Earnings (in thousands of dollars)

	Years ended	December 31,		
	 2011		2010	
Income	 			
Dividends from subsidiaries	\$ 756	\$	1,740	
Management fees from subsidiaries	 427		225	
Total Income	 1,183		1,965	
F				
Expenses	465		482	
Salary and benefits expense Professional fees	108		190	
Professional res	72		85	
Other expenses	113		113	
Total Expenses	 758		870	
Total Expenses	 736		070	
Net income before income tax benefit and undistributed subsidiary net income	425		1,095	
Income tax (benefit)	 (145)		(367)	
Income before undistributed subsidiary net income	570		1,462	
Undistributed subsidiary net income	822		130	
Net Income	\$ 1,392	\$	1,592	
Retained earnings, beginning of period	\$ 37,165	\$	36,963	
Dividends paid in cash	(602)		(1,390)	
Net income	 1,392		1,592	
Retained earnings, end of period	\$ 37,955	\$	37,165	

Statements of Cash Flows (in thousands of dollars)

		ed December 31,
Cash Flows From Operating Activities	2011	2010
Net Income	\$ 1,392	\$ 1,592
Adjustments to net income		
Depreciation	12	13
Undistributed subsidiary income	(822)	
Increase (decrease) in payables	(24)	
(Increase) decrease in receivables from subsidiaries	(130)	
(Increase) decrease in receivables	815	545
(Increase) decrease in other assets	17	(12)
Net Cash Provided by Operating Activities	1,260	1,787
Cash Flows From Investing Activities		
Net (payments to) subsidiaries	(715)	(641)
Net Cash Used in Investing Activities	(715)	(641)
Cash Flows From Financing Activities		
Dividends paid in cash	(602)	(1,390)
Net Cash Used in Financing Activities	(602)	(1,390)
Net Decrease in Cash	(57)	(244)
Cash, beginning of year		314
Cash, end of year	<u>\$ 13</u>	\$ 70
65		
03		



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Highlands Bankshares, Inc. Petersburg, West Virginia

We have audited the accompanying consolidated balance sheets of Highlands Bankshares, Inc. and its subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2011. The management of Highlands Bankshares, Inc. and its subsidiaries (the "Company") is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Highlands Bankshares, Inc. and its subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America.

/s/ Smith Elliott Kearns & Company, LLC Smith Elliott Kearns & Company, LLC

Chambersburg, Pennsylvania March 30, 2012

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

None.

Item 9A. Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2011. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic SEC filings.

Management's Report on Internal Control Over Financial Reporting

Highlands Bankshares, Inc. is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this annual report. The consolidated financial statements and notes included in this annual report have been prepared in conformity with United States generally accepted accounting principles and necessarily include some amounts that are based on management's best estimates and judgments.

The management of Highland's Bankshares, Inc. and its wholly owned subsidiaries is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934 as amended. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements or may not prevent the possibility that a control can be circumvented or overridden. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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

This Annual Report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm.

Changes in Internal Controls

During the period reported upon, there were no significant changes in internal controls of the Company pertaining to its financial reporting and control of its assets or in other factors that materially affected or are reasonably likely to materially affect such control.

Item 9B. Other Information

None

Item 10. Directors, Executive Officers and Corporate Governance

Information required by this item is set forth as portions of our 2012 Proxy Statement, to be filed within 120 days after the end of the Company's fiscal year end, and is incorporated herein by reference. Applicable information required by this item can be found in the 2012 Proxy Statement under the following captions:

- "Compliance with Section 16(a) of the Securities Exchange Act"
- "ELECTION OF DIRECTORS"
- "INFORMATION CONCERNING DIRECTORS AND NOMINEES"
- "REPORT OF THE AUDIT COMMITTEE"

The Company has adopted a Code of Ethics that applies to the Company's Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer and all directors, officers and employees of the Company. A copy of the Company's Code of Ethics covering all employees will be mailed without charge upon request to Corporate Governance, Highlands Bankshares, Inc., P.O. Box 929, Main Street, Petersburg, West Virginia 26847. Any amendments to or waiver from any provision of the Code of Ethics, applicable to the Company's Chief Executive Officer, Chief Financial Officer, or Chief Accounting Officer will be disclosed in a timely fashion via the Company's filing of a Current Report on Form 8-K regarding and amendments to, or waivers of, any provision of the Code of Ethics applicable to the Company's Chief Executive Officer, Chief Financial Officer or Chief Accounting Officer.

Item 11. Executive Compensation

Information required by this item is set forth under the caption "EXECUTIVE COMPENSATION" of our 2012 Proxy Statement, to be filed within 120 days after the end of the Company's fiscal year end, and is incorporated herein by reference.

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

Information required by this item is set forth under the caption "SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT" of our 2012 Proxy Statement, to be filed within 120 days after the end of the Company's fiscal year end, and is incorporated herein by reference

Item 13. Certain Relationships and Related Transactions and Director Independence

Information required by this item is set forth under the caption "CERTAIN RELATED TRANSACTIONS" of our 2012 Proxy Statement, to be filed within 120 days after the end of the Company's fiscal year end, and is incorporated herein by reference.

Most of the directors, limited liability companies of which they may be members, partnerships of which they may be general partners and corporations of which they are officers or directors, maintain normal banking relationships with the Bank. Loans made by the Bank to such persons or other entities were made in the ordinary course of business, were made, at the date of inception, on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons, and did not involve more than normal risk of collectability or present other unfavorable features. See Note Twelve of the consolidated financial statements.

Director John Van Meter is a partner with the law firm of Van Meter and Van Meter, which has been retained by the Company as legal counsel, and it is anticipated that the relationship will continue. Director Jack H. Walters is a partner with the law firm of Walters, Krauskopf & Baker, which provides legal counsel to the Company, and it is anticipated that the relationship will continue.

Item 14. Principal Accounting Fees and Services

Information required by this item is set forth under the caption "Fees of Independent Registered Certified Public Accountants" of our 2012 Proxy Statement, to be filed within 120 days after the end of the Company's fiscal year end, and is incorporated herein by reference.

PART IV.

Item 15.	Exhibits, Financial Statements and Schedules
(a)(1)	Financial Statements:
	Reference is made to Part II, Item 8 of the Annual Report on Form 10-K
(a)(2)	Financial Statement Schedules: These schedules are omitted as the required information is inapplicable or the information is presented in the consolidated financial statements or related notes
(a)(3)	Exhibits. The exhibits listed in the "Exhibits Index" on Page 71 of this Annual Report on Form 10-K included herein are filed herewith or are incorporated by reference from previous filings.
(b)	See (a)(3) above
(c)	See (a)(1) and (a)(2) above
(b) (c)	

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the registrant has duly cause this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HIGHLANDS BANKSHARES, INC.

 /s/ C.E. Porter
 /s/ Jeffrey B. Reedy

 C.E. Porter
 Jeffrey B. Reedy

 President & Chief Executive Officer
 Chief Financial Officer

Date: March 30, 2012 Date: March 30, 2012

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated

Name	Signature	Title	Date
Leslie A. Barr	/s/ Leslie A. Barr	Director	March 30, 2012
Alan L. Brill	/s/ Alan L. Brill	Director; Secretary & Treasurer	March 30, 2012
Jack H. Walters	/s/ Jack H. Walters	Director	March 30, 2012
Gerald W. Smith	/s/ Gerald W. Smith	Director	March 30, 2012
Morris M. Homan	/s/ Morris M. Homan	Director	March 30, 2012
Kathy G. Kimble	/s/ Kathy G. Kimble	Director	March 30, 2012
George L. Ford	/s/ George L. Ford	Director	March 30, 2012
C.E. Porter	/s/ C.E. Porter	Director; President & Chief Executive Officer	March 30, 2012
John G. Van Meter	/s/ John G. Van Meter	Director; Chairman of The Board of Directors	March 30, 2012
L. Keith Wolfe	/s/ L. Keith Wolfe	Director	March 30, 2012
	70		

EXHIBIT INDEX

Exhibit Number	
	Description
3(i)	Articles of Incorporation of Highlands Bankshares, Inc., as restated, are hereby incorporated by reference to Exhibit 3(i) to Highlands Bankshares Inc.'s Form 10-Q filed November 13, 2007.
3(ii)	Amended Bylaws of Highlands Bankshares, Inc. are incorporated by reference to Exhibit 3(ii) to Highlands Bankshares Inc.'s Report on Form 8-K filed January 9, 2008
14	Code of Ethics. The HIGHLANDS BANKSHARES, INC. CODE OF BUSINESS CONDUCT AND ETHICS is hereby incorporated by reference filed as Exhibit 14.1 with Highlands Bankshares Inc.'s Report on Form 8-K filed January 14, 2008
21	Subsidiaries of the Registrant (filed herewith)
31.1	Certification of Chief Executive Officer Pursuant to section 302 of the Sarbanes-Oxley Act of 2002 Chapter 63, Title 18 USC Section 1350 (A) and (B).
31.2	Certification of Chief Financial Officer Pursuant to section 302 of the Sarbanes-Oxley Act of 2002 Chapter 63, Title 18 USC Section 1350 (A) and (B).
32.1	Statement of Chief Executive Officer Pursuant to 18 U.S.C. §1350.
32.2	Statement of Chief Financial Officer Pursuant to 18 U.S.C. § 1350.
101.INS	XBRL Instance Document (1)
101.SCH	XBRL Taxonomy Extension Schema Document (1)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase (1)
101.LAB	XBRL Taxonomy Extension Label Linkbase (1)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase (1)
101.DEF	XBRL Taxonomy Extension Definitions Linkbase (1)
Evhibit 21 Subsidior	ries of the Registrant
	res of the Registrant

The Grant County Bank (incorporated in West Virginia) doing business as The Grant County Bank Capon Valley Bank (incorporated in West Virginia) doing business as Capon Valley Bank HBI Life Insurance Company (incorporated in Arizona) doing business as HBI Life (a) (b) (c)

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER Pursuant to section 302 of the Sarbanes-Oxley Act of 2002 Chapter 63, Title 18 USC Section 1350 (A) and (B)

I, C.E. Porter, certify that:

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

Date: March 30, 2012

C.E. Porter, Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER Pursuant to section 302 of the Sarbanes-Oxley Act of 2002 Chapter 63, Title 18 USC Section 1350 (A) and (B)

I, Jeffrey B. Reedy, certify that:

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

/s/ Jeffrey B. Reedy
Jeffrey B. Reedy, Chief Financial Officer

Date: March 30, 2012

Exhibit 32.1

Statement of Chief Executive Officer Pursuant to 18 U.S.C. § 1350

In connection with the Annual Report of Highlands Bankshares, Inc. (the "Company") on Form 10-K for the period ending December 31, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, as the chief executive officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ C.E. Porter

Date: March 30, 2012 C.E. Porter, Chief Executive Officer

Exhibit 32.2

Statement of Chief Financial Officer Pursuant to 18 U.S.C. § 1350

In connection with the Annual Report of Highlands Bankshares, Inc. (the "Company") on Form 10-K for the period ending December 31, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, as the chief financial officer of the Company, certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Jeffrey B. Reedy

Date: March 30, 2012 Jeffrey B. Reedy, Chief Financial Officer