PINNACLE BANCSHARES
2010 ANNUAL REPORT

PINNACLE BANCSHARES, INC.
AND SUBSIDIARY

CONSOLIDATED FINANCIAL REPORT

DECEMBER 31, 2010

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AND SUBSIDIARY

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Pinnacle Bancshares, Inc.
Jasper, Alabama

We have audited the accompanying consolidated statements of condition of **Pinnacle Bancshares, Inc. and its Subsidiary** as of December 31, 2010 and 2009, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pinnacle Bancshares, Inc. and Subsidiary as of December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Mauldin & Jenkins, LLC

Birmingham, Alabama
April 12, 2011

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PINNACLE BANCSHARES, INC.
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CONDITION
DECEMBER 31, 2010 AND 2009

Assets	2010	2009
Cash and cash equivalents	$ **3,486,659**	$ 4,259,422
Interest bearing deposits in banks	**3,148,883**	277,886
Federal funds sold	**-**	1,950,000
Securities available for sale	**63,140,124**	67,538,084
Restricted equity securities	**1,255,200**	1,342,500
Loans held for sale	**251,141**	678,663
Loans receivable, net of allowance for loan losses of $2,443,604 and $3,575,643, respectively	**113,157,873**	123,875,515
Loans, net	**113,409,014**	124,554,178
Foreclosed assets	**587,450**	374,314
Premises and equipment, net	**6,488,537**	6,712,423
Goodwill	**306,488**	306,488
Bank owned life insurance	**6,777,100**	6,443,714
Accrued interest receivable	**1,034,539**	1,092,177
Other assets	**1,249,028**	1,816,595
Total assets	**$ 200,883,022**	$ 216,667,781
Liabilities and Stockholders' Equity		
Deposits	**175,374,334**	190,891,988
Subordinated debentures	**3,093,000**	3,093,000
Official checks outstanding	**423,622**	916,666
Accrued interest payable	**353,564**	358,475
Other liabilities	**985,544**	765,026
Total liabilities	**180,230,064**	196,025,155
Stockholders' equity		
Common stock, $.01 par value, 2,400,000 shares authorized; 1,872,313 shares issued; 1,270,128 shares outstanding	**18,723**	18,723
Additional paid-in capital	**8,923,223**	8,923,223
Treasury stock, at cost (602,185 shares)	**(7,320,909)**	(7,320,909)
Retained earnings	**17,931,987**	17,836,009
Accumulated other comprehensive income, net of tax	**1,099,934**	1,185,580
Total stockholders' equity	**20,652,958**	20,642,626
Total liabilities and stockholders' equity	**$ 200,883,022**	$ 216,667,781

See Notes to Consolidated Financial Statements.

PINNACLE BANCSHARES, INC.
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
Interest income		
Loans	**$ 7,173,773**	$ 7,888,831
Taxable securities	**2,076,225**	2,349,043
Nontaxable securities	**471,508**	422,318
Other interest	**30,501**	7,867
Total interest income	**9,752,007**	10,668,059
Interest expense		
Deposits	**1,960,362**	2,995,234
Borrowings	**2,000**	7,696
Subordinated debentures	**100,127**	114,956
Total interest expense	**2,062,489**	3,117,886
Net interest income	**7,689,518**	7,550,173
Provision for loan losses	**2,415,000**	3,023,400
Net interest income after provision for loan losses	**5,274,518**	4,526,773
Other income		
Fees and service charges on deposits accounts	**1,215,236**	1,205,548
Service fee income, net	**66,808**	82,858
Fees and charges on loans	**143,327**	179,704
Bank owned life insurance	**333,386**	334,960
Net gain on loans held for sale	**197,207**	285,977
Net gain (loss) on sales of securities available for sale	**(23,107)**	3,965
Total other income	**1,932,857**	2,093,012
Other expenses		
Salaries and employee benefits	**3,243,683**	3,249,542
Occupancy expenses	**1,446,457**	1,389,786
Marketing and professional expenses	**335,288**	356,886
Net loss on real estate owned	**42,862**	269,706
Other operating expenses	**1,468,310**	1,450,018
Total other expenses	**6,536,600**	6,715,938
Income (loss) before income taxes	**670,775**	(96,153)
Income tax expense (benefit)	**15,940**	(296,881)
Net income	**$ 654,835**	$ 200,728
Basic and diluted earnings per share	**$ 0.52**	$ 0.16
Cash dividends per share	**$ 0.44**	$ 0.44
Weighted-average basic and diluted shares outstanding	**1,270,128**	1,270,128

See Notes to Consolidated Financial Statements.

PINNACLE BANCSHARES, INC.
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
Net income	**$ 654,835**	$ 200,728
Other comprehensive income (loss):		
Unrealized holding gains (losses) on securities available for sale arising during the period, net of tax of $61,389 and $264,063, respectively	**(99,857)**	430,809
Reclassification adjustment for (gains) losses realized in net income, net of tax of $8,896 and $1,518, respectively	**14,211**	(2,447)
Other comprehensive income (loss)	**(85,646)**	428,362
Comprehensive income	**$ 569,189**	$ 629,090

See Notes to Consolidated Financial Statements.

PINNACLE BANCSHARES, INC.
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2010 AND 2009

	Common Stock		Additional Paid-in	Treasury	Retained	Accumulated Other Comprehensive	Total Stockholders'
	Shares	Par Value	Capital	Stock	Earnings	Income	Equity
Balance, December 31, 2008	1,872,313	$ 18,723	$ 8,923,223	$ (7,320,909)	$ 18,194,136	$ 757,218	$ 20,572,391
Net income	-	-	-	-	200,728	-	200,728
Cash dividends declared, $0.44 per share	-	-	-	-	(558,855)	-	(558,855)
Other comprehensive income	-	-	-	-	-	428,362	428,362
Balance, December 31, 2009	1,872,313	18,723	8,923,223	(7,320,909)	17,836,009	1,185,580	20,642,626
Net income	-	-	-	-	654,835	-	654,835
Cash dividends declared, $0.44 per share	-	-	-	-	(558,857)	-	(558,857)
Other comprehensive loss	-	-	-	-	-	(85,646)	(85,646)
Balance, December 31, 2010	1,872,313	$ 18,723	$ 8,923,223	$ (7,320,909)	$ 17,931,987	$ 1,099,934	$ 20,652,958

See Notes to Consolidated Financial Statements.

PINNACLE BANCSHARES, INC.
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
OPERATING ACTIVITIES		
Net income	**$ 654,835**	$ 200,728
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**514,943**	492,073
Provision for loan losses	**2,415,000**	3,023,400
Deferred tax expense (benefit)	**138,597**	(511,331)
Amortization expense (accretion income), net	**8,215**	(43,573)
Bank owned life insurance	**(333,386)**	(334,959)
Gain on sale of loans held for sale	**(197,207)**	(285,977)
(Gain) loss on sale of securities available for sale	**23,107**	(3,965)
Loss on sale or write-down of real estate owned	**42,862**	269,706
Proceeds from sales of loans held for sale	**16,355,518**	24,805,221
Origination of loans held for sale	**(15,730,789)**	(24,396,517)
(Increase) decrease in accrued interest receivable	**57,638**	(26,537)
Decrease in accrued interest payable	**(4,911)**	(486,437)
Net other operating activities	**700,113**	(1,181,123)
Net cash provided by operating activities	**4,644,535**	1,520,709
INVESTING ACTIVITIES		
Net loan repayments	**7,910,248**	9,241,236
Net (increase) decrease in federal funds sold	**1,950,000**	(1,950,000)
Net increase in interest-bearing deposits in other banks	**(2,870,997)**	(277,798)
Purchase of securities available for sale	**(20,038,348)**	(15,951,384)
Proceeds from sale of securities available for sale	**10,033,687**	1,014,063
Proceeds from maturing or callable of securities available for sale	**14,233,160**	13,632,883
Proceeds from sale of correspondent bank stock	**87,300**	369,300
Purchase of correspondent bank stock	**-**	(762,600)
Purchase of premises and equipment	**(289,189)**	(290,943)
Proceeds from sales of real estate owned	**136,396**	2,767,258
Net cash provided by investing activities	**11,152,257**	7,792,015
FINANCING ACTIVITIES		
Net decrease in deposits	**(15,517,654)**	(6,586,516)
Decrease in borrowed funds	**-**	(2,025,000)
Increase (decrease) in official checks outstanding	**(493,044)**	220,342
Payments of cash dividends	**(558,857)**	(558,855)
Net cash used in financing activities	**(16,569,555)**	(8,950,029)
Net increase (decrease) in cash and cash equivalents	**(772,763)**	362,695
Cash and cash equivalents at beginning of year	**4,259,422**	3,896,727
Cash and cash equivalents at end of year	**$ 3,486,659**	$ 4,259,422
SUPPLEMENTAL DISCLOSURE		
Cash paid during the year for:		
Interest	**$ 2,067,400**	$ 3,604,323
Taxes	**$ 61,800**	$ 150,000
OTHER NONCASH TRANSACTIONS		
Real estate acquired through foreclosure	**$ 392,394**	$ 896,868

See Notes to Consolidated Financial Statements.

PINNACLE BANCSHARES, INC.
AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Following is a description of the business and the more significant accounting policies followed by Pinnacle Bancshares, Inc. (the "Company") and its wholly-owned subsidiary Pinnacle Bank (the "Bank") in presenting the consolidated financial statements.

Nature of Operations

Pinnacle Bancshares, Inc. is a bank holding company whose principal activity is the ownership and management of its wholly-owned subsidiary, Pinnacle Bank. The Bank is primarily in the business of obtaining funds in the form of various savings and time deposit products and investing those funds in mortgage, consumer, and commercial loans. The Bank operates in seven offices in the central and northwest portions of Alabama and originates its loans in this market area. The Company's principal activities do not constitute separate reportable segments of its business, but encompass traditional banking activities which offer similar products and services within the same primary geographic area and regulatory and economic environment.

Basis of Presentation and Accounting Estimates

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. Significant intercompany transactions and balances have been eliminated in consolidation.

In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet, and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of foreclosed assets and deferred taxes, other-than-temporary impairments of securities, and the fair value of financial instruments.

The Company has evaluated all transactions, events, and circumstances for consideration or disclosure through April 12, 2011, the date these financial statements were available to be issued, and has reflected or disclosed those items within the consolidated financial statements and related footnotes as deemed appropriate.

Cash, Cash Equivalents, and Cash Flows

For purposes of reporting consolidated cash flows, cash, and cash equivalents includes cash on hand, cash items in process of collection, and amounts due from banks. Cash flows from loans, federal funds sold, interest-bearing deposits in other banks, deposits, and official checks outstanding are reported net.

The Bank is required to maintain average balances in cash or on deposit with the Federal Reserve Bank. The total of those reserve balances was approximately $1,195,000 and $1,253,000 at December 31, 2010 and 2009, respectively.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Securities

Management determines the appropriate classification of debt and equity securities at the time of purchase and periodically re-evaluates such designations. Debt securities are classified as securities held to maturity when the Company has the intent and ability to hold the securities to maturity. Securities held to maturity are stated at amortized cost. Debt securities not classified as securities held to maturity or trading account assets and marketable equity securities not classified as trading account assets are classified as securities available for sale. Securities available for sale are stated at estimated fair value with changes in unrealized gains and losses, net of taxes, reported as a component of other comprehensive income (loss). See Note 15 for discussion of determining fair value.

The amortized cost of debt securities classified as securities held to maturity and securities available for sale is adjusted for amortization of premiums and accretion of discounts to maturity, or in the case of mortgage-backed securities, over the estimated life of the security, using the effective yield method. Such amortization or accretion is included in interest income on securities. Realized gains and losses are included in net securities gains (losses). The cost of securities sold is based on the specific identification method.

The Company reviews its securities portfolio on a regular basis to determine if there are any conditions indicating that a security has other-than-temporary impairment. Factors considered in this determination include the length of time and the extent to which the market value has been below cost, the credit standing of the issuer, the Company's intent to sell, and whether it is more likely than not that the Company will have to sell the security before its market value recovers. Activity related to the credit loss component of other-than-temporary impairment is recognized in earnings. For debt securities, the portion of other-than-temporary impairment related to all factors other than credit is recognized in other comprehensive income. See Note 2 for discussion and details of other-than-temporary impairment.

Restricted Equity Securities

The Company is required to maintain an investment in capital stock of various entities. Based on redemption provisions of these entities, the stock has no quoted market value and is carried at cost. At their discretion, these entities may declare dividends on the stock. Management reviews for impairment based on the ultimate recoverability of the cost basis in these stocks. Investments in restricted equity securities consisted of the following:

	December 31,	
	2010	2009
Federal Home Loan Bank of Atlanta	**$ 730,200**	$ 817,500
First National Banker's Bankshares, Inc.	**525,000**	525,000
	$ 1,255,200	$ 1,342,500

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value (LOCOM). For loans carried at LOCOM, gains and losses on loan sales (sales proceeds minus carrying value) are recorded in noninterest income, and direct loan origination costs and fees are deferred at origination of the loan and are recognized in noninterest income upon sale of the loan. The estimated fair value of loans held for sale is based on independent third party quoted prices.

The Company enters into interest rate lock commitments, where customers have locked into mortgages at a set interest rate, and forward sales commitments, which are sales of mortgage loans to third parties at a specified price. These interest rate locks and forward sales commitments qualify as derivatives; however, the change in fair value of these derivatives during the years ended December 31, 2010 and 2009 did not have a material impact on the Company's consolidated financial position or results of operations.

Loans Receivable

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

Loan origination fees for all loans are deferred and recognized as an adjustment of the yield over the life of the loan using the straight-line method.

The accrual of interest on loans is generally discontinued when a loan is 90 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal and interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income or charged to the allowance, unless management believes that the accrual of interest is recoverable through the liquidation of collateral. Interest income on nonaccrual loans is recognized on the cash basis, until the loans are returned to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is considered impaired when it is probable, based on current information and events, the Company will be unable to collect all principal and interest payments due in accordance with 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 when due. Loans that experience insignificant payment delays and payment shortfalls are not classified as impaired. Impaired loans are measured by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Interest on accruing impaired loans is recognized as long as such loans do not meet the criteria for nonaccrual status. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment.

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 expense. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

The allowance is an amount that management believes will be adequate to absorb estimated losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the uncollectibility of loans in light of historical experience, the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, current economic conditions that may affect the borrower's ability to pay, 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. This evaluation does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses, and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For impaired loans, an allowance is established when the discounted cash flows, 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 historical loss experience adjusted for other qualitative factors. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation computed on a straight-line basis over the estimated service lives of the related assets (30 to 50 years for buildings, shorter of lease period or estimated life of 10 to 15 years for leasehold improvements and 3 to 10 years for equipment). Expenditures for maintenance and repairs are charged to operations as incurred; expenditures for renewals and improvements are capitalized and charged to operations through depreciation and amortization charges. Equipment retired or sold is removed from the asset and related accumulated depreciation amounts and any gain or loss resulting therefrom is reflected in the accompanying consolidated statements of operations.

The Company continually evaluates whether events and circumstances have occurred that indicate such long-lived assets have been impaired. Measurement of any impairment of such long-lived assets is based on those assets' fair values and is recognized through a valuation allowance with the resulting charge reflected in the accompanying consolidated statements of operations. There were no impairment losses recorded during any period reported herein.

Transfers of Financial Assets

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Foreclosed Assets

Foreclosed assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less selling costs. Any write-down to fair value at the time of transfer to foreclosed assets is charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. Costs of improvements are capitalized, whereas costs relating to holding foreclosed assets and subsequent write-downs to the value are expensed.

Goodwill

Goodwill represents the excess of cost over the fair value of the net assets and liabilities acquired in a business combination. Goodwill is required to be tested annually for impairment, or whenever events occur that may indicate that the recoverability of the carrying amount is not probable. In the event of an impairment, the amount by which the carrying amount exceeds the fair value would be charged to earnings.

Bank Owned Life Insurance

The Company has bank owned life insurance on certain current and former key officers of the Company. The life insurance policies were purchased to reduce costs associated with certain existing employee benefits. Increases in the cash surrender value of the policies, as well as insurance proceeds received, are recorded as a component of non-interest income.

Income Taxes

The Company accounts for income taxes in accordance with income tax accounting guidance (FASB ASC 740, Income Taxes). On January 1, 2009, the Company adopted the recent accounting guidance related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions.

The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets may be reduced by deferred tax liabilities and a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Share-Based Payments

Stock compensation accounting guidance (FASB ASC 718, Compensation - Stock Compensation) requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. A Black-Scholes model is used to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards and stock grants.

Earnings Per Share

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional potential common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. There were no potential common shares as of December 31, 2010 and 2009.

Comprehensive Income

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

Fair Value of Financial Instruments

Fair values of financial instruments are estimates using relevant market information and other assumptions, as more fully disclosed in Note 15. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Reclassification

Certain amounts in the 2009 consolidated financial statements have been reclassified to conform to the 2010 presentation. These reclassified amounts did not change total stockholder's equity or net income.

Recent Accounting Pronouncements

Accounting Standards Update (ASU) No. 2009-16, *"Transfers and Servicing (Topic 860) — Accounting for Transfers of Financial Assets."* ASU 2009-16 amends prior accounting guidance to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. ASU 2009-16 eliminates the concept of a "qualifying special-purpose entity" and changes the requirements for derecognizing financial assets. ASU 2009-16 also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The provisions of ASU 2009-16 became effective on January 1, 2010 and did not have a significant impact on the Company's financial statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

ASU No. 2010-06, *"Fair Value Measurements and Disclosures (Topic 820) — Improving Disclosures About Fair Value Measurements."* ASU 2010-06 requires expanded disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements. ASU 2010-06 further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) company's should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. The disclosures related to the gross presentation of purchases, sales, issuances and settlements of assets and liabilities included in Level 3 of the fair value hierarchy will be required for the Company beginning January 1, 2011. The remaining disclosure requirements and clarifications made by ASU 2010-06 became effective for the Bank on January 1, 2010. See Note 15, Fair Value of Assets and Liabilities.

ASU No. 2010-20, *"Receivables (Topic 310) — Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses."* ASU 2010-20 requires entities to provide disclosures designed to facilitate financial statement users' evaluation of (i) the nature of credit risk inherent in the entity's portfolio of financing receivables, (ii) how that risk is analyzed and assessed in arriving at the allowance for credit losses and (iii) the changes and reasons for those changes in the allowance for credit losses. Disclosures must be disaggregated by portfolio segment, the level at which an entity develops and documents a systematic method for determining its allowance for credit losses, and class of financing receivable, which is generally a disaggregation of portfolio segment. The required disclosures include, among other things, a rollforward of the allowance for credit losses as well as information about modified, impaired, non-accrual and past due loans and credit quality indicators. ASU 2010-20 will become effective for the Company's financial statements as of December 31, 2011. ASU 2011-01, "Receivables (Topic 310) — Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20," temporarily deferred the effective date for disclosures related to troubled debt restructurings to coincide with the effective date of a proposed accounting standards update related to troubled debt restructurings, which is currently expected to be effective for periods ending after June 15, 2011.

ASU No. 2010-28, *"Intangibles — Goodwill and Other (Topic 350) — When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts."* ASU 2010-28 modifies 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. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist such as if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. ASU 2010-28 will be effective for the Company on January 1, 2011 and is not expected to have a significant impact on the Company's financial statements.

NOTE 2. SECURITIES

The amortized cost, unrealized gross gains and losses, and estimated fair value of securities available for sale are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale				
December 31, 2010:				
Municipal securities	**$ 23,469,360**	**$ 544,661**	**$ (287,448)**	**$ 23,726,573**
U.S. treasury securities	**3,961,606**	**-**	**(152,927)**	**3,808,679**
U.S. Government-sponsored enterprises (GSEs)*	**1,886,860**	**85,760**	**-**	**1,972,620**
Other securities	**716**	**-**	**-**	**716**
Mortgage-backed securities	**32,032,857**	**1,602,014**	**(3,335)**	**33,631,536**
Total securities**	**$ 61,351,399**	**$ 2,232,435**	**$ (443,710)**	**$ 63,140,124**
December 31, 2009:				
Corporate securities	$ 1,018,495	$ -	$ (101,095)	$ 917,400
Municipal securities	11,201,979	405,499	(37,189)	11,570,289
U.S. treasury securities	9,041,167	-	(103,285)	8,937,882
U.S. Government-sponsored enterprises (GSEs)*	1,877,681	79,699	-	1,957,380
Other securities	716	-	-	716
Mortgage-backed securities	42,471,183	1,719,232	(35,998)	44,154,417
Total securities**	$ 65,611,221	$ 2,204,430	$ (277,567)	$ 67,538,084

* Such as Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Federal Home Loan Banks.

** At December 31, 2010, we held no securities of any single issuer (excluding the U.S. Government and U.S. Government-sponsored enterprises) with a book value that exceeded 10% of stockholders' equity.

The amortized cost and estimated fair value of securities available for sale at December 31, 2010 by contractual maturity are shown below. Actual maturities may differ from contractual maturities in mortgage-backed securities because the mortgages underlying the securities may be called or repaid with or without penalty. Therefore, these securities are not included in the maturity categories in the following summary:

	Amortized Cost	Fair Value
Due within one year	$ 666,287	$ 668,590
Due from one to five years	9,353,734	9,434,160
Due from five to ten years	6,929,432	6,895,212
Due in more than ten years	12,369,089	12,510,626
Mortgage-backed securities	32,032,857	33,631,536
	$ 61,351,399	$ 63,140,124

NOTE 2. SECURITIES (Continued)

Securities of approximately $15 million and $30 million at December 31, 2010 and 2009, respectively, were pledged to secure deposits and for other purposes required or permitted by law.

Gains and losses on sales of securities available for sale consist of the following:

	Years Ended December 31,	
	2010	2009
Gross gains	**$ 23,702**	$ 3,965
Gross losses	**(46,809)**	-
Net realized gains (losses)	**$ (23,107)**	$ 3,965

Temporarily Impaired Securities

The following table shows the gross unrealized losses and fair value of the entity's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2010 and 2009.

Available for sale securities that have been in a continuous unrealized loss position are as follows:

	Less Than Twelve Months		Over Twelve Months			
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Total Unrealized Losses	Total Fair Value
December 31, 2010						
Municipal securities	**$ (287,448)**	**$ 7,417,525**	**$ -**	**$ -**	**$ (287,448)**	**$ 7,417,525**
U.S. treasury securities	**(152,927)**	**3,808,680**	**-**	**-**	**(152,927)**	**3,808,680**
Mortgage-backed						
GSE residential	**(2,733)**	**190,409**	**(602)**	**51,196**	**(3,335)**	**241,605**
Total	**$ (443,108)**	**$ 11,416,614**	**$ (602)**	**$ 51,196**	**$ (443,710)**	**$ 11,467,810**
December 31, 2009						
Corporate securities	$ -	$ -	$ (101,095)	$ 917,400	$ (101,095)	$ 917,400
Municipal securities	(4,751)	515,248	(32,438)	1,139,426	(37,189)	1,654,674
U.S. treasury securities	(103,285)	8,937,882	-	-	(103,285)	8,937,882
Mortgage-backed						
GSE residential	(28,734)	801,543	(7,264)	546,255	(35,998)	1,347,798
Total	$ (136,770)	$ 10,254,673	$ (140,797)	$ 2,603,081	$ (277,567)	$ 12,857,754

Municipal securities. The unrealized losses on the thirteen investments in municipal securities were caused by interest rate increases. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2010.

United States treasury securities. The unrealized losses on the four investments in United States Treasury securities were caused by interest rate increases. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2010.

NOTE 2. SECURITIES (Continued)

Temporarily Impaired Securities (Continued)

GSE residential mortgage-backed securities. The unrealized losses associated with the Company's investment in two GSE mortgage-backed securities were caused by interest rate increases. The contractual cash flows of those investments are guaranteed by an agency of the U.S. Government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost bases of the Company's investments. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intent to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2010.

NOTE 3. LOANS

The composition of loans is summarized as follows:

	December 31,	
	2010	2009
Real estate – commercial	**$ 40,695,750**	$ 38,312,629
Real estate – construction	**7,532,730**	16,746,809
Real estate – 1-4 family	**41,074,659**	44,351,589
Real estate – other	**533,972**	608,825
Commercial	**20,601,070**	20,890,712
Consumer	**5,105,715**	6,501,363
	115,543,896	127,411,927
Deferred loan costs	**57,581**	37,231
Allowance for loan losses	**(2,443,604)**	(3,573,643)
Loans, net	**$ 113,157,873**	$ 123,875,515

The Company has a credit concentration in residential and commercial real estate mortgage loans. Approximately 78% and 79% at December 31, 2010 and 2009, respectively, of the Company's total gross loan portfolio represented first or second mortgage residential and commercial real estate loans. Substantially all of the Company's loan customers are located in the Company's primary lending areas of Walker, Winston, Jefferson, and Shelby counties in Alabama. Although the Company believes that its underwriting standards are generally conservative, including a policy calling for low loan to collateral values, the ability of its borrowers to meet their mortgage obligations is dependent upon local economic conditions.

Changes in the allowance for loan losses are as follows:

	Years Ended December 31,	
	2010	2009
Balance, beginning of year	**$ 3,573,643**	$ 1,650,705
Provision for loan losses	**2,415,000**	3,023,400
Loans charged off	**(3,740,093)**	(1,190,758)
Recoveries of loans previously charged off	**195,054**	90,296
Balance, end of year	**$ 2,443,604**	$ 3,573,643

NOTE 3. LOANS (Continued)

In the ordinary course of business, the Company has granted loans to certain related parties, including directors, executive officers, and their affiliates. The interest rates on these loans were substantially the same as rates prevailing at the time of the transaction and repayment terms are customary for the type of loan. Changes in related party loans for the year ended December 31, 2010 are as follows:

Balance, beginning of year	$	723,128
Changes in related parties, net		231,391
Advances		38,472
Repayments		(309,664)
Balance, end of year	$	683,327

A loan is considered impaired, in accordance with the impairment accounting guidance (FASB ASC 310-10-35-16), when based on current information and events, it is probable that the Company will be unable to collect all amounts due from the borrower in accordance with the contractual term of the loan. Impaired loans include loans modified in troubled debt restructuring where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection.

Included in the various loan categories in the impaired loans totals below are troubled debt restructurings. At December 31, 2010 and 2009 the Company had $1,342,000 and $1,501,000, respectively, in loans that were modified in troubled debt restructuring and impaired. Of these amounts, all were performing in accordance with their modified terms as of December 31, 2010.

The following is a summary of information pertaining to impaired loans, nonaccrual loans, and loans past due ninety days or more:

	As of and for the Years Ended December 31,	
	2010	2009
Impaired loans with a valuation allowance	**$ 4,851,028**	$ 8,298,661
Impaired loans without a valuation allowance	**1,839,566**	-
Total impaired loans	**$ 6,690,594**	$ 8,298,661
Valuation allowance related to impaired loans	**$ 1,163,445**	$ 2,854,948
Total nonaccrual loans	**1,336,405**	884,223
Total loans past due ninety days or more and still accruing	**390,994**	146,350
Average investment in impaired loans	**6,116,845**	6,118,511
Interest income recognized on impaired loans	**371,728**	70,213

NOTE 4. FORECLOSED ASSETS

A summary of foreclosed assets is presented as follows:

	Years Ended December 31,	
	2010	2009
Balance, beginning of year	**$ 374,314**	$ 2,542,249
Additions, including capitalized expenses	**392,394**	935,302
Disposals	**(136,396)**	(2,882,237)
Provision for losses	**(42,862)**	(221,000)
Balance, end of year	**$ 587,450**	$ 374,314

NOTE 5. PREMISES AND EQUIPMENT

Premises and equipment are summarized as follows:

	December 31,	
	2010	2009
Land	**$ 1,219,463**	$ 1,219,463
Buildings and leasehold improvements	**8,488,535**	8,441,802
Furniture, fixtures, and equipment	**3,365,128**	6,339,817
Automobiles	**74,657**	87,855
	13,147,783	16,088,937
Less accumulated depreciation	**(6,659,246)**	(9,376,514)
	$ 6,488,537	$ 6,712,423

The Company had noncancelable operating leases for the main and branch office sites. Occupancy expenses for the fiscal years ended December 31, 2010 and 2009 include rental expense under these leases of $124,699 and $129,760, respectively. Future rental payments subject to periodic renegotiations required under these leases are as follows:

2011	$ 72,953
2012	74,839
2013	75,753
2014	76,693
2015	77,662
Thereafter	268,800
	$ 646,700

The Company has a sublease agreement for the building in which the main office branch is located that generated income of $105,636 for the fiscal years ended December 31, 2010 and 2009.

NOTE 6. DEPOSITS

The aggregate amount of time deposits in denominations of $100,000 or more at December 31, 2010 and 2009 was $39,268,297 and $56,095,873, respectively. The scheduled maturities of time deposits at December 31, 2010 are as follows:

2011	$ 71,430,849
2012	9,795,061
2013	3,064,437
2014	992,127
2015	444,157
Thereafter	94,893
	$ 85,821,524

At December 31, 2010 and 2009, overdraft demand and savings deposits reclassified to loans totaled $77,099 and $105,152, respectively.

NOTE 7. SUBORDINATED DEBENTURES

On December 22, 2003, the Company established Pinnacle Capital Trust I ("Trust"), a wholly-owned statutory business trust. The Company is the sole sponsor of the Trust and acquired the Trust's common securities for $93,000. The Trust was created for the exclusive purpose of issuing 30-year capital trust securities ("Trust Preferred Securities") in the aggregate amount of $3,000,000 and using proceeds to purchase $3,093,000 of junior subordinated debentures ("Subordinated Debentures") issued by the Company. The sole assets of the Trust are the Subordinated Debentures. The Company's $93,000 investment in the Trust is included in other assets in the accompanying consolidated balance sheet and the $3,093,000 obligation of the Company is included in subordinated debentures.

The Trust Preferred Securities bear a floating interest rate of 2.85% over 3-month LIBOR (3.14% at December 31, 2010) which is set each quarter and matures on December 22, 2033. Distributions are payable quarterly. The Trust Preferred Securities are subject to mandatory redemption upon repayment of the Subordinated Debentures at their stated maturity date or their earlier redemption in an amount equal to their liquidation amount plus accumulated and unpaid distributions to the date of redemption. The Company guarantees the payment of distributions and payments for redemption or liquidation of the Trust Preferred Securities to the extent of funds held by the Trust. Pinnacle Bancshares, Inc.'s obligation under the subordinated debentures together with the guarantee and other back-up obligation, in aggregate, constitute a full and unconditional guarantee by the Company of the obligations of the Trust under the Trust Preferred Securities.

The subordinated debentures are unsecured, bear an interest rate equal to the spread paid by the Trust on the Trust Preferred Securities which is set each quarter and matures on December 30, 2033. Interest is payable quarterly. The Company may defer the payment of interest at any time for a period not exceeding 20 consecutive quarters provided that deferral period does not extend past the stated maturity. During any such deferral period, distributions on the Trust Preferred Securities will also be deferred and the Company's ability to pay dividends on the common shares will be restricted.

Subject to approval by the Federal Reserve Bank of Atlanta, the Trust Preferred Securities may be redeemed prior to maturity at the Company's option on or after January 7, 2009. The Trust Preferred Securities may also be redeemed at any time in whole (but not in part) in the event of unfavorable changes in laws or regulations that result in (1) the Trust becoming subject to federal income tax on income received on the Subordinated Debentures, (2) interest payable by the Company on the subordinated debentures becoming non-deductible for federal tax purposes, or (3) the requirement for Trust Preferred Securities as "Tier I Capital" under the Federal Reserve capital adequacy guidelines.

NOTE 8. BORROWED FUNDS

The Company has an available unused line of credit with First National Banker's Bank totaling $7,300,000 at December 31, 2010. There were no advances outstanding at December 31, 2010 or 2009.

In addition to the federal funds line of credit mentioned above, the Company has an available unused line of credit with the Federal Reserve Bank. Under the agreement with the Federal Reserve, the Company is allowed to borrow up to the fair market value of the available for sale securities pledged to the Federal Reserve Bank. There were no outstanding advances at December 31, 2010 and 2009, and thus no securities were required to be pledged to the Federal Reserve Bank.

The Company also has an available unused line of credit with the Federal Home Loan Bank of Atlanta, Georgia. Any advances from this line of credit will be secured by pledged securities available for sale and certain real estate loans owned by the Company. At December 31, 2010 the total borrowing capacity available through the FHLB was approximately $12,081,632. There were no outstanding advances at December 31, 2010 and 2009.

NOTE 9. INCOME TAXES

The allocation of income tax expense between current and deferred income taxes is as follows:

	Years Ended December 31,	
	2010	2009
Current	**$ (122,657)**	$ 214,450
Deferred	**138,597**	(511,331)
Income tax expense (benefit)	**$ 15,940**	$ (296,881)

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

	Years Ended December 31,	
	2010	2009
Tax provision at federal statutory rate	**$ 228,065**	$ (32,693)
Tax-exempt interest	**(152,222)**	(143,588)
Cash surrender value income	**(113,351)**	(113,886)
State income taxes	**30,465**	(40,472)
Other items, net	**22,983**	33,758
Income tax expense (benefit)	**$ 15,940**	$ (296,881)

NOTE 9. INCOME TAXES (Continued)

The components of the net deferred tax liabilities, included in other liabilities, are as follows:

	December 31, 2010	December 31, 2009
Deferred tax assets:		
Alternative minimum tax credit	**$ 245,408**	$ -
Loan loss reserves	**935,656**	1,368,348
Other real estate losses	**23,311**	37,047
Other	**21,308**	5,988
	1,225,683	1,411,383
Deferred tax liabilities:		
Depreciation	**(665,774)**	(729,147)
Unrealized gain on securities available for sale	**(688,791)**	(741,283)
Other	**(36,094)**	(19,824)
	(1,390,659)	(1,490,254)
Net deferred tax liabilities	**$ (164,976)**	$ (78,871)

NOTE 10. COMPENSATION AND BENEFITS

The Company maintains a noncontributory profit sharing plan and a contributory 401(k) plan. The Company's contributions to these plans were $83,564 and $86,270 in fiscal years ended December 31, 2010 and 2009, respectively.

The Company has an employment agreement with the chief executive officer which provides for compensation and benefits in the event the chief executive officer is terminated. The maximum aggregate liability at December 31, 2010 for termination is approximately $487,500.

NOTE 11. LOAN COMMITMENTS

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amount recognized in the balance sheets. The majority of all commitments to extend credit and standby letters of credit are variable rate instruments.

The Company's exposure to credit loss is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments. A summary of the Company's commitments is as follows:

	December 31, 2010	December 31, 2009
Commitments to extend credit	**$ 21,173,175**	$ 29,143,868
Financial standby letters of credit	**470,400**	419,000
	$ 21,643,575	$ 29,562,868

NOTE 11. LOAN COMMITMENTS (Continued)

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 amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies, but may include accounts receivable, inventory, property and equipment, residential real estate, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Collateral held varies and is required in instances which the Company deems necessary.

At December 31, 2010 and 2009, the carrying amount of liabilities related to the Company's obligation to perform under standby letters of credit was insignificant. The Company has not been required to perform on any standby letters of credit, and the Company has not incurred any losses on financial standby letters of credit for the years ended December 31, 2010 and 2009.

NOTE 12. CONTINGENCIES

In the normal course of business, the Company is involved in various legal proceedings. In the opinion of management, any liability resulting from such proceedings would not have a material effect on the Company's financial statements.

NOTE 13. LONG-TERM INCENTIVE COMPENSATION PLAN

The Company maintained a 1996 Stock Option and Incentive Plan ("Option Plan"), which provided for a number of forms of stock-based compensation for key employees of the Company. Under the Option Plan, eligible employees have been awarded incentive and nonqualified stock options, stock appreciation rights, and restricted stock. The Option Plan provided for the issuance of up to 170,000 shares of the Company's common stock. In addition, each option vested three years after the grant date and expired no later than ten years after the grant date. The exercise price of each option was determined by the stock option committee but, in the case of incentive stock options, the price was not less than the fair value on the grant date. The Company used the fair value method for accounting for stock based employee compensation. There were no equity awards granted during 2010 or 2009. All outstanding options expired during 2009.

A summary of the status of the Company's stock option plan at December 31, 2009 and the changes during the year then ended is as follows:

	Shares	Weighted-Average Exercise Price
Outstanding at end of year	17,833	$ 10.13
Granted	-	-
Exercised	-	-
Forfeited	(17,833)	-
Outstanding at end of year	-	$ -
Exercisable at end of year	-	$ -
Fair value of options granted	N/A	

NOTE 14. REGULATORY MATTERS

Dividends are paid by the Company from funds provided by dividends from the Bank. However, certain regulatory restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends, loans, or advances. As of December 31, 2010**,** the Bank was unable to declare dividends without regulatory approval.

The Company and the Bank are subject to various regulatory capital requirements that prescribe quantitative measures of the Company's and Bank's assets, liabilities, and certain off-balance sheet items. The regulators have also imposed qualitative guidelines for capital amounts and classifications such as risk weightings, capital components, and other details. The quantitative measures to ensure capital adequacy require that the Company and the Bank maintain amounts and ratios, as set forth in the schedule below, of Total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier I capital to average total assets (as defined). Failure to meet minimum capital requirements can initiate certain actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Management believes, as of December 31, 2010 and 2009, that the Company and the Bank meet all capital adequacy requirements imposed by its regulators.

As of December 31, 2010 and 2009, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum Total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There have been no conditions or events since that notification that management believes have changed the institution's category.

Actual capital amounts as well as required and well capitalized Tier I, Total, and Tier I leverage ratios as of December 31, 2010 and 2009 for the Bank are as follows:

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in Thousands)			
As of December 31, 2010:						
Total Capital to Risk Weighted Assets:						
Consolidated	**$ 24,011**	**18.1%**	**$ 10,631**	**8.0%**	**N/A**	**N/A**
Bank	**$ 22,439**	**16.9%**	**$ 10,636**	**8.0%**	**$ 13,295**	**10.0%**
Tier 1 Capital to Risk Weighted Assets:						
Consolidated	**$ 22,340**	**16.8%**	**$ 5,316**	**4.0%**	**N/A**	**N/A**
Bank	**$ 20,768**	**15.6%**	**$ 5,318**	**4.0%**	**$ 7,977**	**6.0%**
Tier 1 Capital to Average Assets:						
Consolidated	**$ 22,340**	**10.7%**	**$ 8,338**	**4.0%**	**N/A**	**N/A**
Bank	**$ 20,768**	**10.0%**	**$ 8,334**	**4.0%**	**$ 10,418**	**5.0%**
As of December 31, 2009:						
Total Capital to Risk Weighted Assets:						
Consolidated	$ 24,075	16.6%	$ 11,581	8.0%	N/A	N/A
Bank	$ 22,820	15.8%	$ 11,574	8.0%	$ 14,467	10.0%
Tier 1 Capital to Risk Weighted Assets:						
Consolidated	$ 22,244	15.3%	$ 5,791	4.0%	N/A	N/A
Bank	$ 20,989	14.5%	$ 5,787	4.0%	$ 8,680	6.0%
Tier 1 Capital to Average Assets:						
Consolidated	$ 22,244	10.3%	$ 8,619	4.0%	N/A	N/A
Bank	$ 20,989	9.7%	$ 8,615	4.0%	$ 10,769	5.0%

NOTE 15. FAIR VALUE OF ASSETS AND LIABILITIES

Determination of Fair Value

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 Fair Value Measurements and Disclosures topic (FASB ASC 820), 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 upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The 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 at 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 point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 - Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities that are traded in an active exchange market, as well as certain U.S. treasury and U.S. Government-sponsored enterprise debt securities that are highly liquid and are actively traded in over-the-counter markets.

Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

NOTE 15. FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and Cash Equivalents, Interest-Bearing Deposits in Banks, and Federal Funds Sold: The carrying amounts of cash and short-term instruments approximate fair values based on the short-term nature of the assets.

Securities Available for Sale: Where quoted prices are available in an active market, we classify the securities within level 1 of the valuation hierarchy. Securities are defined as both long and short positions. Level 1 securities include highly liquid government bonds and exchange-traded equities.

If quoted market prices are not available, we estimate fair values using pricing models and discounted cash flows that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, and credit spreads. Examples of such instruments, which would generally be classified within level 2 of the valuation hierarchy, include GSE obligations, corporate bonds, municipal securities, and other securities. Mortgage-backed securities are included in level 2 if observable inputs are available. In certain cases where there is limited activity or less transparency around inputs to the valuation, we classify those securities in level 3.

Restricted Equity Securities: The carrying amount of restricted equity securities is its cost basis.

Loans Held for Sale: Substantially all of the Company's loans held for sale, primarily to third-party investors, have a readily determinable fair value. Fair values for these loans are based on quoted market prices, where available. If not available, fair values are based on market prices of comparable instruments. The carrying amount of accrued interest on these instruments approximates its fair value.

Loans Receivable: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair value for fixed rate loans are estimated using discounted cash flow analyses, using market interest rates for comparable loans. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

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

Subordinated Debt: The carrying amount of subordinated debt approximates its fair value.

Accrued Interest: The carrying amounts of accrued interest approximate fair value.

Off-Balance Sheet Credit-Related Instruments: Fair values for off-balance sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

NOTE 15. FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

Assets Measured at Fair Value on a Recurring Basis

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

The following table presents financial assets measured at fair value on a recurring basis:

		Fair Value Measurements at December 31, 2010 Using		
	Assets/Liabilities Measured at Fair Value December 31, 2010	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservabl Inputs (Level 3)
		(Dollars in Thousands)		
Available for sale securities	**$ 63,140,124**	**$ -**	**$ 63,140,124**	**$ -**

		Fair Value Measurements at December 31, 2009 Using		
	Assets/Liabilities Measured at Fair Value December 31, 2009	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(Dollars in Thousands)		
Available for sale securities	$ 67,538,084	$ -	$ 67,538,084	$ -

Assets Measured at Fair Value on a Nonrecurring Basis

Following is a description of the valuation methodologies used for instruments measured at fair value on a nonrecurring basis and recognized in the accompanying balance sheet, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Impaired Loans

Loan impairment is reported when full payment under the loan terms is not expected. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate, or the fair value of collateral if the loan is collateral dependent. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to require increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan is confirmed. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan impairment as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan impairment as nonrecurring Level 3.

NOTE 15. FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

Assets Measured at Fair Value on a Nonrecurring Basis

Foreclosed Assets

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

The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the FASB ASC 820 valuation hierarchy (as described above) as of December 31, 2010 and 2009, for which a nonrecurring change in fair value has been recorded during the years ended December 31, 2010 and 2009.

	Fair Value Measurements Using				
	Total	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Year Ended December 31, 2010 Total Gains (Losses)**
Impaired loans	**$ 4,638,267**	**$ -**	**$ -**	**$ 4,638,267**	**$ (1,134,470)**
Foreclosed assets	**587,450**	**-**	**-**	**587,450**	**(42,862)**
					$ (1,177,332)

	Fair Value Measurements Using				
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Year Ended December 31, 2009 Total Gains (Losses)
Impaired loans	$ 5,443,713	$ -	$ -	$ 5,443,713	$ (2,854,948)
Foreclosed assets	374,314	-	-	374,314	(269,706)
					$ (3,124,654)

NOTE 15. FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

The carrying amount and estimated fair value of the Company's financial instruments were as follows:

	December 31,			
	2010		2009	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
	(Dollars in Thousands)			
Financial assets:				
Cash and cash equivalents	**$ 3,487**	**$ 3,487**	$ 4,259	$ 4,259
Interest-bearing deposits in banks	**3,149**	**3,149**	278	278
Federal funds sold	**-**	**-**	1,950	1,950
Securities available for sale	**63,140**	**63,140**	67,538	67,538
Restricted equity securities	**1,255**	**1,255**	1,343	1,343
Loans held for sale	**251**	**251**	679	679
Loans receivable, net	**113,158**	**114,178**	123,876	125,100
Accrued interest receivable	**1,035**	**1,035**	1,092	1,092
Financial liabilities:				
Deposits	**175,374**	**175,975**	190,892	191,464
Subordinated debentures	**3,093**	**3,093**	3,093	3,093
Accrued interest payable	**354**	**354**	358	358

NOTE 16. PARENT COMPANY FINANCIAL INFORMATION

The following information presents the condensed statements of condition of Pinnacle Bancshares, Inc. as of December 31, 2010 and 2009 and the condensed statements of income and cash flows for the years then ended.

CONDENSED STATEMENTS OF CONDITION

	2010	2009
	(Dollars in Thousands)	
Assets		
Cash and cash equivalents	**$ 1,421**	$ 739
Investment in unconsolidated subsidiary	**93**	93
Investment in Pinnacle Bank	**22,175**	22,481
Other assets	**85**	453
Total assets	**$ 23,774**	$ 23,766
Liabilities and stockholders' equity		
Subordinated debentures	**$ 3,093**	$ 3,093
Other liabilities	**28**	30
Total liabilities	**3,121**	3,123
Stockholders' equity	**20,653**	20,643
Total liabilities and stockholders' equity	**$ 23,774**	$ 23,766

NOTE 16. PARENT COMPANY FINANCIAL INFORMATION (Continued)

CONDENSED STATEMENTS OF INCOME

	2010	2009
	(Dollars in Thousands)	
Income		
Dividend income from Pinnacle Bank	**$ 942**	$ 1,279
Interest income	**9**	5
	951	1,284
Expense, other	**75**	82
Income before distributions in excess of undistributed earnings	**876**	1,202
Distributions in excess of undistributed earnings of subsidiary	**(221)**	(1,001)
Net income	**$ 655**	$ 201

CONDENSED STATEMENTS OF CASH FLOWS

	2010	2009
	(Dollars in Thousands)	
OPERATING ACTIVITIES		
Net income	**$ 655**	$ 201
Adjustments to reconcile net income to net cash provided by operating activities:		
Distributions in excess of undistributed earnings of subsidiary	**221**	1,001
(Increase) decrease in other assets	**367**	(42)
Decrease in other liabilities	**(2)**	(33)
Net cash provided by operating activities	**1,241**	1,127
INVESTING ACTIVITIES		
Net change in interest-bearing deposits in other banks	**-**	167
Net cash provided by investing activities	**-**	167
FINANCING ACTIVITIES		
Dividends paid	**(559)**	(559)
Net cash used in financing activities	**(559)**	(559)
Net increase in cash and cash equivalents	**682**	735
Cash and cash equivalents at beginning of year	**739**	4
Cash and cash equivalents at end of year	**$ 1,421**	$ 739

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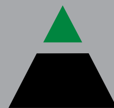

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