2012 ANNUAL REPORT

BEO BANCORP

BEO Bancorp and Subsidiary

Consolidated Financial Statements

With Independent Auditors' Report

Years Ended December 31, 2012 and 2011

C O N T E N T S

BEO BANCORP

P.O. BOX 39 Heppner, OR 97836 Administrative Office: 279 N. Main Heppner, OR 97836 Phone: (541) 676-0201

Message to our stockholders

I am pleased to present to you the financial statements and operating results of BEO Bancorp and Bank of Eastern Oregon for 2012. We are reporting strong profitability trends and we continue to make headway by cleaning up our balance sheet from the lasting effects of the “great recession”.

As we look back at 2012 we saw continued strong performance in our agricultural economy with relatively high commodity prices and good production. The banking industry as a whole continues to improve. The rate of bank failures continues to drop, even with national and global economies that continue to show uncertainty.

2012 was a very good year for BEO Bancorp. Consolidated after tax net income for BEO Bancorp in 2012 was $2,462,000; up 22.4% from 2011. Return on Average Assets for 2012 was 0.90% compared to 0.79% in 2011. Return on Average Equity was 13.23% in 2012 vs. 12.12% in 2011. Net earnings per share were $2.55 in 2012 up 16.9% from the 2011 level of $2.18. By themselves these results show strong improvement over last year, but they also compare favorably to industry peers. Net interest income was a primary driver for our profitability up 6.2% from 2011. This profitability was attained even as we continue to clean up our balance sheet. In 2012 we were able to reduce other real estate owned by 41.4%; we also continue to take the prudent steps to address provision for potential loan losses by making sure that our loan loss reserve was adequately funded.

Your Bank continued to experience steady and managed growth in 2012. Stockholders’ equity growth was strong going from $17,554,000 to $19,667,000; an increase of 12.0%. Bank of Eastern Oregon’s regulatory capital which is indicative of our overall soundness is at 10.13% as of December 31, 2012. Total assets were at $284,848,000 up 9.4% year over year; deposits set another all-time high of $252,888,000 up 9.8% from 2011. Net loans increased 12.4% to $224,776,000 also a high point for the Bank. The impressive growth figures come in spite of continued low interest rates and a very competitive market place. We are quite pleased with the growth and are appreciative of the confidence placed in our institution by our customers. This growth does not happen by accident. It is a testament to the support of our customers, shareholders and the exemplary job our employees do in meeting and surpassing the expectations of our customer base. I am truly thankful to work among such a superb group of individuals that continually impress me with their work ethic and professionalism. Our employees truly care about our customers and our rural eastern Oregon communities. I am grateful for their dedication and daily efforts.

As shareholders, thank you for your continued investment and confidence in BEO Bancorp. I cordially invite you to attend our annual meeting of shareholders where we will provide a recap of 2012, elect a director and offer a glimpse at what we expect in 2013. We will meet on Thursday, April 25, 2013 at 7:00 pm at the St. Patrick’s Catholic Church parish hall in Heppner, OR. Please note the time of **7:00 pm**.

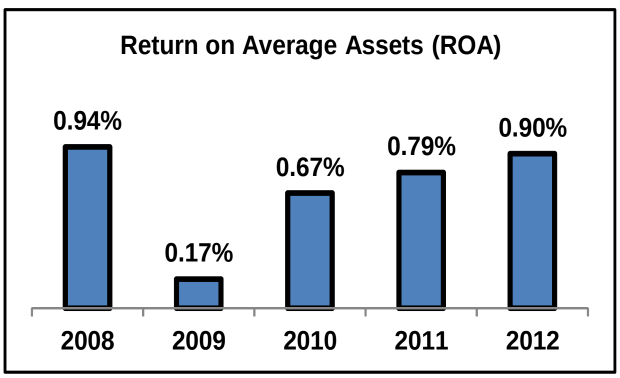
Sincerely,

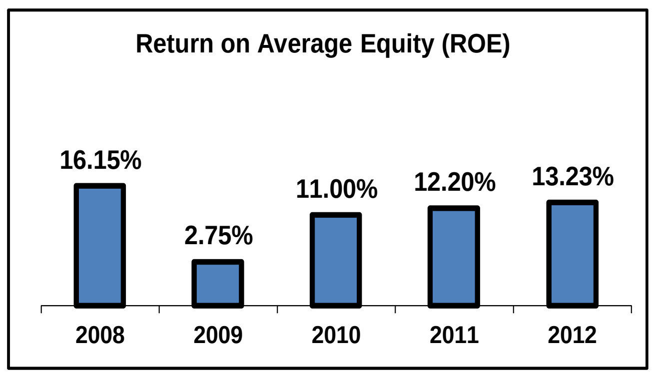
Jeff L. Bailey
President and CEO
BEO Bancorp

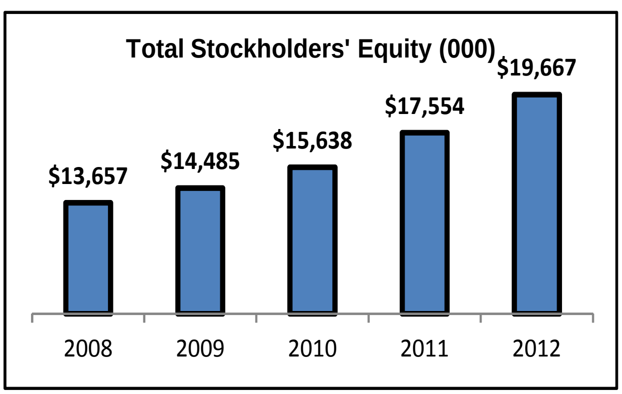
FINANCIAL HIGHLIGHTS

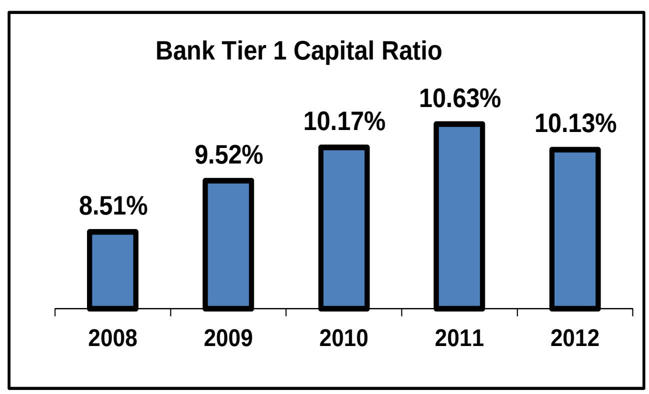
2008-2012

	2008	2009	2010	2011	2012
Return on Average Assets	0.94%	0.17%	0.67%	0.79%	0.90%
Return on Average Equity	16.15%	2.75%	11.00%	12.20%	13.23%
Net Income	$2,046,579	$386,721	$1,656,016	$2,011,567	$2,461,996
Net Income Per Share	$2.32	$0.43	$1.80	$2.18	$2.55
Total Equity (000)	$13,657	$14,485	$15,638	$17,554	$19,667
Total Assets (000)	$228,082	$239,841	$251,734	$260,437	$284,848
Bank Tier 1 Capital Ratio	8.51%	9.52%	10.17%	10.63%	10.13%









December 31, 2012

Board of Directors

Bradley B Anderson
Farmer/Rancher

Joel Peterson
Farmer

Gary Neal, Vice Chairman
General Manager, Port of Morrow

E. George Koffler
Retired Banker

Robert M Armstrong, Chairman
Certified Public Accountant

Ned E Clark
Rancher

Linda LaRue
Retired Banker

Jeffery L Bailey
President, Chief Executive Officer
Bank of Eastern Oregon and BEO Bancorp

Executive Officers

Jeffery L Bailey, President and Chief Executive Officer
Mark D Lemmon, Executive Vice President and Chief Financial Officer
Gary L Propheter, Executive Vice President and Chief Operations Officer

Senior Vice Presidents

Becky Kindle, Senior Vice President of Operations
John Qualls, Senior Vice President and Senior Loan Officer
Edward Rollins, Senior Vice President of Credit Administration

Vice Presidents

John Bailey, Commercial Loan Officer
Janet Dezellem, Controller
James Gardner, Commercial Loan Officer
Tricia Gunderson, Human Resources Manager
Kevin McCabe, Information Systems Manager
Daniel McNeley, Commercial Loan Officer
Robert Quinton, Commercial Loan Officer
Robert Williams, Commercial Loan Officer

Assistant Vice Presidents

Christy Correa, Finance Coordinator
Dawna Dougherty, Compliance Officer
Joyce Moser, Mortgage Loan Officer
Jill Pambrun, Commercial Loan Officer
Janice Provencher, John Day Branch Manager
Rhonda Shaffer, Commercial Loan Officer
Sheryl A Walters, Arlington Branch Manager
Karen Cossit, Fossil Branch Manager
Jennifer Smith, Moro Branch Manager

Independent Auditors' Report

To the Board of Directors
BEO Bancorp:

Report on the Financial Statements
We have audited the accompanying consolidated financial statements of BEO Bancorp and Subsidiary ("BEO") which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

Auditor's Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our 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 consolidated financial statements are free of material misstatement.

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

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

Opinion
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BEO as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Isler CPA, LLC

March 8, 2013

1976 Garden Ave., Eugene, OR 97403
541-342-5161 www.islercpa.com

BEO Bancorp and Subsidiary
Consolidated Balance Sheets

	December 31	
	2012	2011
ASSETS		
Cash and cash equivalents:		
Cash and due from banks	**$ 2,646,207**	$ 2,363,908
Interest bearing deposits at other financial institutions	**20,455,267**	9,209,310
Federal funds sold	**-**	3,030,000
Total cash and cash equivalents	**23,101,474**	14,603,218
Investment securities available-for-sale	**14,299,138**	22,131,723
Investment securities held-to-maturity	**5,096,211**	5,490,300
Loans, less allowance for loan losses	**224,776,246**	199,907,278
Interest receivable	**3,035,543**	2,474,995
Federal Home Loan Bank stock	**549,900**	559,700
Property, less accumulated depreciation	**6,674,890**	6,901,852
Core deposit intangible, less accumulated amortization	**131,267**	279,433
Deferred taxes, net	**779,617**	908,022
Foreclosed assets	**862,010**	1,471,800
Cash surrender value of bank owned life insurance	**4,297,270**	4,151,781
Other assets	**1,244,131**	1,556,695
	261,746,223	245,833,579
Total assets	**$ 284,847,697**	$ 260,436,797
LIABILITIES and STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Noninterest-bearing demand	**$ 63,847,748**	$ 54,529,544
Savings and interest-bearing demand	**132,759,664**	117,788,160
Time, $100,000 and over	**14,315,746**	14,629,595
Other time	**41,964,624**	43,384,020
	252,887,782	**230,331,319**
Subordinated debentures	**10,295,750**	11,322,000
Interest payable	**89,773**	100,225
Other liabilities	**1,907,323**	1,128,937
Total liabilities	**265,180,628**	242,882,481
Stockholders' equity:		
Common stock, $5 par value, 3,000,000 shares authorized 972,550 outstanding December 31, 2012 and 3,000,000 authorized 922,118 outstanding December 31, 2011	**2,661,105**	2,408,945
Additional paid-in capital	**1,806,927**	1,690,193
Retained earnings	**15,007,170**	13,031,449
Accumulated other comprehensive income	**191,867**	423,729
Total stockholders' equity	**19,667,069**	17,554,316
Total liabilities and stockholders' equity	**$ 284,847,697**	$ 260,436,797

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

BEO Bancorp and Subsidiary
Consolidated Statements of Income

	Year Ended December 31	
	2012	2011
Interest income:		
Interest and fees on loans:		
Taxable	**$ 13,199,467**	$ 12,473,110
Nontaxable	**346,739**	432,566
Interest on investment securities:		
Taxable	**354,654**	540,333
Nontaxable	**320,947**	188,976
Interest on federal funds sold and short-term time deposits	**43,541**	35,685
	14,265,348	13,670,670
Interest expense	**1,392,179**	1,548,808
Net interest income	**12,873,169**	12,121,862
Provision for loan losses	**1,090,000**	1,325,000
Net interest income after provision for loan losses	**11,783,169**	10,796,862
Noninterest income:		
Service charges	**1,415,776**	1,432,069
Mortgage banking income	**255,750**	306,770
Other	**338,457**	343,459
	2,009,983	2,082,298
Noninterest expense:		
Salaries and employee benefits	**6,286,705**	5,825,225
Occupancy expense	**674,746**	661,440
Equipment expense	**708,456**	690,359
Foreclosed asset expenses	**82,359**	457,184
Other	**2,472,890**	2,587,385
	10,225,156	10,221,593
Income before income taxes	**3,567,996**	2,657,567
Provision for income taxes	**1,106,000**	646,000
Net income	**$ 2,461,996**	$ 2,011,567
Basic earnings per share	**$ 2.55**	$ 2.18
Diluted earnings per share	**$ 2.43**	$ 2.18

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

BEO Bancorp and Subsidiary
Consolidated Statements of Profit and Other Comprehensive Income

	Year Ended December 31	
	2012	**2011**
Net Income	**$ 2,461,996**	$ 2,011,567
Other comprehensive income (loss) net of tax:		
Unrealized gains (losses) on investment securities	**(58,360)**	290,531
Reclassification of gains realized on sale of investment securities	**(31,879)**	(16,571)
Unrealized loss on cash flow hedge instrument	**(141,623)**	-
Other comprehensive income (loss)	**(231,862)**	273,960
Comprehensive Income	**2,230,134**	2,285,527

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

BEO Bancorp and Subsidiary
Consolidated Statements of Changes in Stockholders' Equity
For the Years Ended December 31, 2012 and 2011

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, January 1, 2011	$ 2,408,945	$ 1,690,193	$ 11,388,730	$ 149,769	$15,637,637
Net income			2,011,567		$ 2,011,567
Other comprehensive income (loss):				273,960	$ 273,960
Cash dividends ($.40 per share)			(368,848)		(368,848)
Balance, December 31, 2011	2,408,945	1,690,193	13,031,449	423,729	17,554,316
Issuance of 120,296 shares	**601,480**	**445,365**			**1,046,845**
Repurchase of 69,864 shares	**(349,320)**	**(328,631)**			**(677,951)**
Net income			**2,461,996**		**2,461,996**
Other comprehensive income (loss):				**(231,862)**	**(231,862)**
Cash dividends ($.50 per share)			**(486,275)**		**(486,275)**
Balance, December 31, 2012	**$ 2,661,105**	**$ 1,806,927**	**$ 15,007,170**	**$ 191,867**	**$19,667,069**

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

BEO Bancorp and Subsidiary
Consolidated Statements of Cash Flows

	Year Ended December 31	
	2012	**2011**
Cash flows from operating activities:		
Net income	**$ 2,461,996**	$ 2,011,567
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**462,507**	472,914
Net gains or losses on property dispositions	**(53,500)**	48,243
Net gains on sales of investment securities	**(53,131)**	(16,571)
Amortization of investment premiums, net	**65,173**	85,587
Amortization of core deposit intangible and organization expenses	**148,166**	171,174
Provision for loan losses	**1,090,000**	1,325,000
Write down of foreclosed assets	**46,000**	236,963
Increase in cash value of life insurance	**(145,489)**	(169,850)
Deferred income taxes	**270,000**	330,000
Change in:		
Interest receivable and other assets	**(247,984)**	380,008
Deferred loan fees	**93,116**	(108,375)
Accrued interest and other liabilities	**531,200**	25,072
Net cash provided by operating activities	**4,668,054**	4,791,732
Cash flows from investing activities:		
Proceeds from maturities of investment securities	**13,914,764**	12,443,809
Proceeds from sale of available-for-sale securities	**951,072**	306,747
Purchase of investment securities	**(6,787,927)**	(14,298,480)
Purchase of loans	**(557,131)**	(3,220,645)
Proceeds from sale of foreclosed assets	**684,099**	401,619
Proceeds from sale of FHLB stock	**9,800**	-
Loans originated, net of principal collected	**(25,561,563)**	(7,232,731)
Purchases of property	**(235,744)**	(404,301)
Net cash provided (used) in investing activities	**(17,582,630)**	(12,003,982)
Cash flows from financing activities:		
Net increase in deposits	**22,556,463**	6,761,099
Reduction of subordinated debt	**(1,026,250)**	-
Issuance of common stock	**1,046,845**	-
Repurchase of common stock	**(677,951)**	-
Dividends paid	**(486,275)**	(368,848)
Net cash provided by financing activities	**21,412,832**	6,392,251
Net increase (decrease) in cash and cash equivalents	**8,498,256**	(819,999)
Cash and cash equivalents, beginning of year	**14,603,218**	15,423,217
Cash and cash equivalents, end of year	**$ 23,101,474**	$ 14,603,218

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

BEO Bancorp and Subsidiary
Consolidated Statements of Cash Flows, Continued

	Year Ended December 31	
	2012	2011
Supplemental information:		
Cash paid during the year for:		
Income taxes	**$ 629,095**	$ 623,140
Interest	**1,402,631**	1,599,701
Change in unrealized losses on investment securities available-for-sale, net of deferred income taxes	**90,239**	273,960
Transfer of loans to foreclosed assets	**66,610**	1,141,336

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

BEO Bancorp and Subsidiary
Notes to Consolidated Financial Statements

1. Summary **of Significant Accounting Policies:**

Basis of Presentation – The consolidated financial statements include the accounts of BEO Bancorp ("Bancorp"), a bank holding company, and its wholly-owned subsidiary, Bank of Eastern Oregon (the "Bank"). All significant intercompany accounts and transactions have been eliminated in consolidation. Bancorp has also established subsidiary grantor trusts in connection with the issuance of trust preferred securities (see Note 11). In accordance with the requirements of ASC 810 the accounts and transactions of these trusts are not consolidated in the accompanying consolidated financial statements.

Description of Business - The Bank provides commercial and consumer financing, banking and mortgage lending and other services in Northeastern Oregon. Its activities include the usual lending and deposit functions of a commercial bank: commercial, agricultural, real estate, installment, credit card and mortgage loans; checking, money market, time deposit and savings accounts; internet banking and bill payment; automated teller machines and safe deposit facilities. Additionally, the Bank originates and sells mortgage loans into the secondary market and offers investment services.

Financial Statement Presentation – The preparation of the financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect reported amounts and related disclosures, and actual results could differ from those estimates. The most significant estimates are the allowance for loan losses and fair value estimates. The Company has evaluated subsequent events through March 8, 2013, the date the financial statements are available for distribution. Certain prior year amounts may have been reclassified to conform to the current year presentation. Such reclassifications have no effect on previously reported net income.

Cash and Cash Equivalents – For purposes of presentation in the consolidated statements of cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption "cash and due from banks". Such amounts include interest bearing deposits and federal funds sold on a short-term basis and may exceed amounts insured by FDIC.

Investment Securities – Securities for which management has the positive intent and ability to hold to maturity are classified as held-to-maturity and are reported at cost adjusted for remaining balances of premiums or discounts.

Securities purchased with the intent to sell in the near term are classified as trading securities and are reported at estimated fair market value with unrealized gains or losses reported in non interest income. The Bank had no trading securities at December 31, 2012 or 2011.

1. Summary **of Significant Accounting Policies,** Continued:

Securities not classified as held-to-maturity or as trading securities are classified as available-for-sale. Securities available-for-sale are held for indefinite periods of time and may be sold in response to changes in market interest rates, shifts in the maturity mix or concentration of bank assets or liabilities or to alleviate liquidity demands. Securities designated as available-for-sale are carried at estimated fair value. Unrealized gains and losses are excluded from earnings and are credited or charged to other comprehensive income in stockholders' equity, net of applicable deferred taxes. Interest income on debt securities is included in income using the effective interest method. Gains and losses realized on sales of securities are recognized on the specific identification method.

The Bank recognizes other-than-temporary impairments for debt securities classified as available for sale in accordance with ASC 320. Accordingly, the Bank assesses whether it intends to sell, or it is more likely than not that it will be required to sell a security before recovery of its amortized cost basis less any current-period credit losses. For debt securities that are considered other-than-temporarily impaired and that the Bank does not intend to sell and will not be required to sell prior to recovery of the amortized cost basis, the Bank separates the amount of the impairment into the amount that is credit related (credit loss component) and the amount due to all other factors. The credit loss component is recognized in earnings and is the difference between the security's amortized cost basis and the present value of its expected future cash flows discounted at the security's effective yield. The remaining difference between the security's fair value and the present value of future expected cash flows is due to factors that are not credit related and, therefore, is not required to be recognized as losses in the income statement, but is recognized in other comprehensive income. The Bank has not recognized an other-than-temporary impairment of its debt securities as management believes all unrealized losses on investment securities at December 31, 2012 are temporary (see note 3).

Loans and Income Recognition – Loans are stated at the amount of unpaid principal, net of deferred loan origination fees, premiums or discounts on purchased loans, and an allowance for loan losses. Interest on loans is calculated using the simple-interest method on daily balances of the principal amount outstanding. Accrual of interest is discontinued on a loan when management believes, after considering economic and business conditions and collection efforts that the borrower's financial condition is such that collection of the interest is doubtful. Cash receipts on non-accrual loans are first recorded as principal collections. Loan origination fees, net of associated direct costs, if significant, are amortized by the interest method over the contractual life of the loan. Premiums and discounts on loans purchased are amortized using the straight line method over a period management believes best matches the cash flow and risks associated with the loan.

1. Summary **of Significant Accounting Policies,** Continued:

Allowance for Loan Losses – The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectibility of the principal is unlikely. The allowance is an amount that management considers adequate to absorb possible losses on existing loans that may become uncollectible based on evaluations of the collectibility of loans and prior loss experience. The evaluations take into consideration such factors as changes in the nature and value of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay.

A loan is considered impaired when management believes that it is probable that all amounts will not be collected according to the contractual terms. An impaired loan is valued using the present value of expected cash flows discounted at the loan's effective interest rate, the observable market price of the loan or the estimated fair value of the loan's collateral or related guaranty. Loans deemed impaired have a specifically allocated reserve within the allowance for loan losses.

The allowance and provision are estimates that are necessarily subjective and may be adjusted as more current information becomes available. Any adjustment could be significant.

The Bank classifies reserves for potential losses on commitments to loan in other liabilities.

Federal and state bank regulatory agencies, as an integral part of their examination process, periodically review the Bank's reserve for loan losses. Such agencies may require the Bank to recognize additions to the reserve in the future based on their judgment of the information available to them at the time of their examinations.

Federal Home Loan Bank Stock – The investment in Federal Home Loan Bank ("FHLB") stock is a restricted investment carried at cost, which is based on the ultimate recoverability at par value. As a member of the FHLB system, the Bank is required to maintain a minimum level of investment in FHLB stock based on borrowings. At December 31, 2012, the minimum required investment was $101,000. The Bank may request redemption at par value of any stock in excess of the amount it is required to hold. Stock redemptions are at the discretion of the FHLB.

Property – Property is stated at cost, net of accumulated depreciation. Additions, betterments and replacements of major units are capitalized. Expenditures for normal maintenance, repairs and replacements of minor units are charged to expense as incurred. Gains or losses realized from sales or retirements are reflected in operations currently. Depreciation is computed by the straight-line method over the estimated useful lives of the assets.

1. Summary **of Significant Accounting Policies,** Continued:

Core Deposit Intangible – Core deposit intangible is stated at cost, net of accumulated amortization. Amortization is recorded on an accelerated basis through 2013, with periodic evaluation for impairment.

Foreclosed Assets – Assets acquired through, or in lieu of, loan foreclosure are held-for-sale and are initially recorded at fair value at the date of foreclosure based on current appraisals, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other noninterest expense.

Advertising – Advertising costs are generally charged to expense during the year in which they are incurred.

Income Taxes – Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are calculated on differences between financial statement and tax bases of assets and liabilities using tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established to reduce the net carrying amount of deferred tax assets if it is determined to be more likely than not, that all or some of the potential deferred tax asset will not be recognized.

Uncertain tax positions are accounted for in accordance with ASC 740 which prescribes recognition and measurement standards for uncertain income tax positions. The Standard provides guidance on recognition, derecognition, interest, penalties and disclosure. There is no material impact of potential tax uncertainties on Bancorp's financial condition or results of operations at December 31, 2012.

Fair Value – Bancorp applies the hierarchy and framework for measuring fair value, disclosure about fair value measurements and the reliability of valuation inputs as provided in ASC 820. When determining the fair value, Bancorp considers the transaction to sell an asset or transfer a liability occurs in the principal or at least the most advantageous market for that asset or liability. Within the hierarchy, Level 1 instruments use observable market prices for the identical item in active markets and have the most reliable valuations. Level 2 instruments are valued through broker/dealer quotation or through market-observable inputs for similar items in active markets, including forward and spot prices, interest rates and volatilities. Level 3 instruments are valued using inputs not observable in an active market such as company-developed future cash flow estimates, and are considered the least reliable. Valuations for all of Bancorp's and the Bank's financial instruments fall within Levels 2 and 3.

1. Summary **of Significant Accounting Policies,** Continued:

Derivative Instruments – Bancorp and the Bank use a derivative financial instrument (interest rate swaps) to limit exposure to changes in interest rates related to a subordinated debenture. The derivatives entered into by Bancorp and the Bank are designated as cash flow hedge with perfect effectiveness between changes in the value of the interest rate swap and the hedged instrument (subordinated debenture liability). The derivative and related hedged debenture are recognized in the balance sheet at their fair value. Changes in the fair value of a derivative that is highly effective, along with the loss or gain on the hedged liability that is attributable to the hedged risk, are recorded in current-period earnings. Bancorp and the Bank formally documents all relationships between hedging instruments and formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative that is used in the hedging transaction is highly effective in offsetting changes in fair values of hedged items.

Bancorp and the Bank would discontinue hedge accounting when: (a) it is determined that a derivative is no longer effective in offsetting changes in the fair value of the associated hedged item; (b) the derivative expires or is sold, terminated, or exercised; or (c) management determines that designation of the derivative as a hedge instrument is no longer appropriate. The hedged liability would no longer be adjusted for changes in fair value and the derivative would be carried at its fair value in the balance sheet, with changes in its fair value recognized in current-period earnings.

Recently Issued Accounting Pronouncements Adopted in 2012 – In April 2011 FASB issued Accounting Standard Update No. ASU 2011-02, *Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*. This ASU sets forth the guidance to assist creditors in determining whether a modification of the terms of a receivable meets the criteria to be considered a troubled debt restructuring, both for purposes of recording an impairment and for disclosure of troubled debt restructurings.

In June 2011 FASB issued Accounting Standard Update No. ASU 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income.* This ASU requires all non owner changes in stockholders' equity to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements.

There was no material impact on the Bank's results of operations or financial condition upon adoption of the new standards.

1. Summary **of Significant Accounting Policies,** Continued:

Recently Issued Accounting Pronouncements Effective in 2013 and 2014 – In December 2011 FASB issued Accounting Standard Update No. ASU 2011-11, *Receivables (Topic 310): Disclosures about Offsetting Assets and Liabilities.* In January 2013 FASB issued a clarification for *Disclosures about Offsetting Assets and Liabilities* ASU No. 2013-01 These ASUs set forth the guidance applicable to derivatives accounted for in accordance with Topic 815, Derivatives and Hedging, including bifurcated embedded derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. This update is effective for the Bank for the year ended December 31, 2013.

In February 2013 FASB issued Accounting Standard Update No. ASU 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The objective of this Update is to improve the reporting of reclassifications out of accumulated other comprehensive income. The amendments in this Update seek to attain that objective by requiring an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP) to be reclassified in its entirety to net income. This update is effective for the Bank for the year ended December 31, 2014.

In February 2013 FASB issued Accounting Standard Update No. ASU 2013-03, *Clarifying the Scope and Applicability of a Particular Disclosure to Nonpublic Entities.* The main objective of this Update is to clarify the scope and applicability of a particular disclosure to nonpublic entities that resulted from the issuance of Accounting Standards Update No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. Contrary to the stated intent of Update 2011-04 to exempt all nonpublic entities for a particular disclosure, that Update's amendments to Topic 825 suggested that nonpublic entities that have total assets of $100 million or more or that have one or more derivative instruments would not qualify for the intended exemption. This update is effective for the Bank for the year ended December 31, 2013.

The Bank is evaluating the impact that these amendments have on future financial statements.

2. Cash and **Due From Banks:**

The Bank is required to maintain an average reserve balance with the Federal Reserve Bank or maintain such reserve balance in the form of cash. The required reserve balances at December 31, 2012 and 2011 were approximately $121,000 and $354,000, respectively, and were met by holding cash and maintaining an average balance with the Federal Reserve Bank.

3. Investment **Securities:**

The amortized cost and estimated fair values of investment securities at December 31, 2012 and 2011 are as follows:

2012

Available-for-sale:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government agencies	**$ 4,670,776**	**$ 124,102**	**$ (7,024)**	**$ 4,787,854**
Government guaranteed loan pools	**6,103,560**	**255,996**	**(1,875)**	**6,357,681**
Mortgage-backed securities	**309,928**	**1,068**	**-**	**310,996**
Obligations of municipal entities	**2,709,586**	**135,835**	**(2,814)**	**2,842,607**
	$ 13,793,850	**$ 517,001**	**$ (11,713)**	**$ 14,299,138**

Held-to-maturity:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of municipal entities	**$ 5,096,211**	**$ 753,112**	**$ -**	**$ 5,849,323**
	$ 5,096,211	**$ 753,112**	**$ -**	**$ 5,849,323**

2011

Available-for-sale:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of U.S. Government agencies	$ 10,099,177	$ 194,025	$ (21,950)	$ 10,271,252
Government guaranteed loan pools	6,355,417	263,841	(460)	6,618,798
Mortgage-backed securities	1,169,208	74,843	-	1,244,051
Obligations of municipal entities	3,865,909	131,713	-	3,997,622
	$ 21,489,711	$ 664,422	$ (22,410)	$ 22,131,723

Held-to-maturity:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Obligations of municipal entities	$ 5,490,300	$ -	$ (88,817)	$ 5,401,483
	$ 5,490,300	$ -	$ (88,817)	$ 5,401,483

3. Investment **Securities,** Continued:

Investment securities that were in unrealized loss positions as of December 31, 2012 and 2011 are presented in the following tables, based on the length of time that individual securities were in unrealized loss positions.

Securities in Unrealized Loss Positions as of December 31, 2012

	Less than 12 Months		**12 Months or Longer**		**Total**	
	Fair Value	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Obligations of U.S. Government agencies	**$ 1,243,567**	**$ (7,024)**	**$ -**	**$ -**	**1,243,567**	**(7,024)**
Government guaranteed loan pools	**386,248**	**(1,875)**	**-**	**-**	**386,248**	**(1,875)**
Obligations of municipal entities	**280,122**	**(2,814)**	**-**	**-**	**280,122**	**(2,814)**
Total	**$ 1,909,937**	**$ (11,713)**	**$ -**	**$ -**	**$ 1,909,937**	**$ (11,713)**

Securities in Unrealized Loss Positions as of December 31, 2011

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government agencies	$ 5,977,090	$ (21,950)	$ -	$ -	$ 5,977,090	$ (21,950)
Government guaranteed loan pools	148,464	(20)	60,596	(440)	209,060	(460)
Total	$ 6,125,554	$ (21,970)	$ 60,596	$ (440)	$ 6,186,150	$ (22,410)

The unrealized losses on investment securities were caused by interest rate increases subsequent to the purchase of the securities and are considered temporarily impaired. It is expected that the securities will not be settled at a price less than the amortized cost of the investment. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Bank has the ability and intent to hold these investments until a market price recovery or to maturity, the unrealized losses on these investments are not considered other-than-temporarily impaired.

3. Investment Securities, Continued:

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

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 3,323,189	$ 3,405,045	$ -	$ -
Due after one year through five years	1,507,694	1,534,129	-	-
Due after five years	8,653,039	9,048,968	5,096,211	5,849,323
Mortgage-backed securities	309,928	310,996	-	-
	$13,793,850	$14,299,138	$ 5,096,211	$ 5,849,323

Proceeds from the sale of securities were $951,072 in 2012 and $306,747 in 2011.

At December 31, 2012, investment securities with amortized costs of $10,298,929 and estimated fair values of $10,718,294 were pledged for public deposits ($10,428,127 and $10,822,210 in 2011, respectively).

4. Loans**:**

Major classifications of loans by type of collateral at December 31 are as follows:

	2012	2011
Farmland Loans	**$ 66,949,480**	$ 56,049,401
Commercial real estate loans	**47,293,883**	41,673,090
Agriculture loans	**39,642,709**	39,917,626
Government guaranteed loans	**23,384,627**	20,647,466
Commercial loans	**24,892,392**	17,348,173
Real estate loans	**16,436,428**	16,239,673
Municipal loans	**5,930,698**	7,681,478
Consumer loans	**3,238,153**	3,373,126
	227,768,370	202,930,033
Deferred loan origination fees	**(525,143)**	(432,027)
	227,243,227	202,498,006
Allowance for loan losses	**(2,466,981)**	(2,590,728)
	$ 224,776,246	$ 199,907,278

The loan portfolio at December 31, 2012 and 2011 includes $177,560,843 and $156,690,116, respectively, of loans which have a variable rate of interest. The December 31, 2012 amount includes $160,163,119 of loans with interest rates at their contractual floors.

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balance of such serviced loans was $5,415,333 and $6,329,507 at December 31, 2012 and 2011, respectively.

The total loans outstanding on December 31 which were on a nonaccrual basis, contractually past due 90 days or more as to interest or principal payments are as follows:

	Recorded Investment Nonaccrual Loans	Unpaid Principal Nonaccrual Loans	Loans Past Due 90 Days or More and Still Accruing
2012			
Farmland	**$ 1,923,432**	**$ 2,314,953**	**$ -**
Commercial real estate	**2,703,951**	**3,028,015**	**-**
Agriculture	**31,984**	**31,984**	**-**
Commercial	**322,969**	**322,969**	**-**
Real estate	**207,016**	**207,016**	**-**
	$ 5,189,352	**$ 5,904,937**	**$ -**
2011			
Farmland	$ 709,660	$ 714,684	$ -
Commercial real estate	949,329	1,785,580	-
Agriculture	62,345	62,345	-
Government Guaranteed	-	-	974,495
Commercial	36,969	36,969	-
Real estate	298,621	442,894	-
	$ 2,056,924	$ 3,042,472	$ 974,495

4. Loans, Continued:

The following is an analysis of impaired loans as of December 31:

2012	**Impaired Loans**				
	With a Related Allowance	**Without a Related Allowance**	**Total Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
Farmland	**$ -**	**$2,121,621**	**$ 2,121,621**	**$ 2,513,141**	**$ -**
Commercial real estate	**-**	**3,953,255**	**3,953,255**	**4,281,431**	**-**
Agriculture	**-**	**31,984**	**31,984**	**31,984**	**-**
Commercial	**-**	**1,449,711**	**1,449,711**	**1,450,334**	**-**
Real estate	**-**	**251,042**	**251,042**	**251,476**	**-**
	$ -	**$7,807,613**	**$ 7,807,613**	**$ 8,528,366**	**$ -**

2011	Impaired Loans				
	With a Related Allowance	Without a Related Allowance	Total Recorded Investment	Unpaid Principal Balance	Related Allowance
Farmland	$ -	$2,916,895	$ 2,916,895	$ 2,929,701	$ -
Commercial real estate	617,400	4,309,422	4,926,822	5,986,019	87,112
Agriculture	484,233	56,502	540,735	543,150	197,883
Commercial	-	1,238,800	1,238,800	1,239,706	-
Real estate	361,178	343,167	704,345	849,097	25,000
	$1,462,811	$8,864,786	$10,327,597	$11,547,673	$ 309,995

The average recorded investment in impaired loans was approximately $8,316,174 and $10,821,344 in 2012 and 2011, respectively. Interest income recognized on impaired loans totaled $190,313 and $602,437 in 2012 and 2011, respectively. Interest income which would have been realized on non-accrual loans if they had remained current and still accruing was approximately $283,074 and $178,905 in 2012 and 2011, respectively.

4. Loans, Continued:

The following is information regarding loans accounted for as Troubled Debt Restructurings (TDR) that occurred during the years ended December 31:

2012			**Recorded Investment After Modification**			
	Number of TDR Loans	**Recorded Investment Before Modification**	**Modified for Interest Rates**	**Modified for Repayment Terms**	**Modified for Interest Rates and Repayment Terms**	**Total**
Farmland Loans	**2**	**$2,331,658**	**$ -**	**$ -**	**$2,331,658**	**$ 2,331,658**
Commercial real estate loans:	**3**	**2,751,531**	**-**	**335,272**	**2,416,259**	**2,751,531**
Commercial loans	**3**	**356,628**	**-**	**356,628**	**-**	**356,628**
Real estate loans	**2**	**401,804**	**-**	**401,804**	**-**	**401,804**
Total	**10**	**$5,841,621**	**$ -**	**$1,093,704**	**$4,747,917**	**$ 5,841,621**

2011			Recorded Investment at December 31, 2011			
	Number of TDR Loans	Recorded Investment Before Modification	Modified for Interest Rates	Modified for Repayment Terms	Modified for Interest Rates and Repayment Terms	Total
Real estate loans	1	$ 213,135	$ -	$ 213,135	$ -	$ 213,135
Total	1	$ 213,135	$ -	$ 213,135	$ -	$ 213,135

None of the loans accounted for as TDR were in default as of December 31, 2012. At December 31, 2012 the Bank had unfunded commitments on TDR loans of $56,956. There were no unfunded commitments at December 31, 2011. Loans are accounted for as TDR when significant concessions have been granted that would not have otherwise been considered except for the borrower's financial difficulties. Concessions may include extended repayment terms such as interest only payments or lengthened maturities, or interest rate modifications and are granted to improve the likelihood that the borrower will be able to repay the obligation. TDR loans are included in impaired loans and the methodology for evaluating credit losses and accrual status is the same as for other impaired loans.

5. Allowance **for Loan Losses:**

The Bank maintains an allowance for loan losses ("ALLL") to absorb losses resulting from the inherent risks of lending. The balance of the ALLL is reviewed at least quarterly to assess the adequacy relative to probable estimated losses within the loan portfolio. The methodology is consistent with the Contingencies and Receivables topics of the FASB ASC and did not significantly change during 2012 or 2011. The ALLL includes a general allowance based on quantitative and qualitative factors on non impaired loans plus specific reserves on impaired loans established to account for credit attributes of the individual relationships. Credit risk is managed through established policies and procedures including lending limits, diversification, approval requirements, and an ongoing comprehensive review process. The review process includes assigning a numerical risk rating to a loan when originated, and then modifying that risk rating as circumstances dictate.

These Loan risk ratings are assigned as follows:

A rating of 1-2 indicates low apparent credit risk.
A rating of 3-4 indicates average to above average potential credit risk.
A rating of 5-6 indicates weaknesses and factors displaying potential credit risk that requires a higher level of management attention.
A rating of 7 indicates a probable loss but the amount is not specifically determined.
A rating of 8 indicates specific loss has been indentified and charge-off is imminent.

5. Allowance **for Loan Losses,** Continued**:**

A detailed analysis of the ALLL by major portfolio segment as of December 31:

2012

			Allowance for Loan Losses					
	Weighted Average Risk Rating	**Recorded Investment in Loans**	**Beginning Balance**	**Net Charge-off (Recovery)**	**Provision**	**Ending Balance**	**Specific Reserve**	**General Allocation**
Farmland loans	**3.09**	**$ 66,691,022**	**$ 270,843**	**$ 555,773**	**$ 480,000**	**$ 195,070**		**$ 195,070**
Commercial real estate loans	**3.17**	**47,162,029**	**1,467,325**	**435,797**	**425,000**	**1,456,528**	**-**	**1,456,528**
Agriculture loans	**3.21**	**39,637,238**	**365,703**	**20,427**	**15,000**	**360,276**	**-**	**360,276**
Government guaranteed loans	**1.67**	**23,357,807**	**17,226**	**99,980**	**100,000**	**17,246**	**-**	**17,246**
Commercial loans	**2.98**	**24,880,136**	**169,575**	**(3,524)**	**50,000**	**223,099**	**-**	**223,099**
Real estate loans	**3.23**	**16,383,954**	**213,011**	**97,640**	**18,000**	**133,371**	**-**	**133,371**
Municipal loans	**2.68**	**5,893,272**	**25,060**	**-**	**-**	**25,060**	**-**	**25,060**
Consumer loans	**3.18**	**3,237,769**	**61,985**	**7,654**	**2,000**	**56,331**	**-**	**56,331**
Total		**$ 227,243,227**	**$2,590,728**	**$1,213,747**	**$1,090,000**	**$2,466,981**	**$ -**	**$2,466,981**

2011

			Allowance for Loan Losses					
	Weighted Average Risk Rating	Recorded Investment in Loans	Beginning Balance	Net Charge-off (Recovery)	Provision	Ending Balance	Specific Reserve	General Allocation
Farmland loans	3.17	$ 55,823,441	$ 338,320	$ 277,477	$ 210,000	$ 270,843	$ -	$ 270,843
Commercial real estate loans	3.52	41,571,988	1,903,728	1,291,403	855,000	1,467,325	87,112	1,380,213
Agriculture loans	3.24	39,909,492	215,703	-	150,000	365,703	197,883	167,820
Government guaranteed loans	1.70	20,647,466	16,226	-	1,000	17,226	-	17,226
Commercial loans	3.00	17,327,938	149,167	(18,908)	1,500	169,575	-	169,575
Real estate loans	3.31	16,204,974	269,510	161,499	105,000	213,011	25,000	188,011
Municipal loans	2.68	7,640,013	23,560	-	1,500	25,060	-	25,060
Consumer loans	3.18	3,372,694	59,588	(1,397)	1,000	61,985	-	61,985
Total		$ 202,498,006	$2,975,802	$1,710,074	$1,325,000	$2,590,728	$309,995	$2,280,733

6. Property:

Property at December 31 consists of the following:

	2012	2011
Land	**$ 762,238**	$ 762,238
Buildings and improvements	**7,416,114**	7,298,513
Furniture and equipment	**3,709,171**	3,661,942
	11,887,523	11,722,693
Accumulated depreciation	**(5,212,633)**	(4,820,841)
	$ 6,674,890	$ 6,901,852

7. Core **Deposit Intangible:**

The core deposit intangible and accumulated amortization balances are:

	2012	2011
Purchase cost in 2003	**$ 2,109,512**	$ 2,109,512
Accumulated amortization	**(1,978,245)**	(1,830,079)
	$ 131,267	$ 279,433

Forecasted amortization for 2013, after which it will be fully amortized, is $131,267.

8. Other **Assets:**

	2012	2011
Prepaid expenses	**$ 998,778**	$ 1,203,766
Investment in unconsolidated subsidiaries (Trusts) (Note 11)	**217,000**	217,000
Income tax deposits	**-**	94,377
Capitalized subordinated debt issuance costs, net of $150,000 and $140,000 amortization in 2012 and 2011, respectively	**20,000**	30,000
Other items, net	**8,353**	11,552
	$ 1,244,131	$ 1,556,695

9. Deposits**:**

The scheduled maturities of time deposits at December 31 are as follows:

	2012	2011
Less than one year	**$ 43,954,599**	$ 45,526,209
One to three years	**8,918,867**	9,315,869
Over three years	**3,406,904**	3,171,537
	$ 56,280,370	$ 58,013,615

10. **Borrowings:**

At December 31, 2012, the Bank has unused credit available totaling approximately $36,368,000 from the Federal Home Loan Bank of Seattle, $20,000,000 of federal funds lines with correspondent banks and $4,848,000 with the Federal Reserve Bank of San Francisco. There were no balances outstanding on these credit lines at December 31, 2012 or December 31, 2011.

The Federal Home Loan Bank line of credit, when borrowed against, is secured by certain investment securities and real estate loans. The Federal Reserve Bank line of credit is secured by pledged real estate and agricultural loans.

11. Subordinated Debentures:

As of December 31, 2012, Bancorp had two wholly-owned trusts ("Trusts") that were formed to issue trust preferred securities and related common securities. The Trusts issued Capital Securities ("Trust Preferred Securities") and invested the proceeds in a like amount of Junior Subordinated Debentures ("Debentures") of BEO Bancorp. Interest distributions on the Trust Preferred Securities are payable quarterly and are deferrable, at Bancorp's option, for up to five years. The Debentures bear the same terms and interest rates as the related Trust Preferred Securities. The Debentures are the sole assets of the Trusts. Bancorp has unconditionally guaranteed all of the obligations of the Trusts.

The Trust Preferred Securities are mandatorily redeemable, in whole or in part, upon repayment of the underlying Debentures at their stated maturities or their earlier redemption. The Debentures are redeemable prior to maturity at Bancorp's option.

In accordance with provisions of ASC 810 the Trusts have not been consolidated in these financial statements. The $7,217,000 of Debentures issued to the Trusts as of December 31, 2012 is reflected as subordinated debentures in the consolidated balance sheets. The common stock issued by the Trusts is recorded in other assets (Note 8).

In December 2009 through March 2010 Bancorp issued a total of $4,105,000 in 7% 5-year Callable Convertible Subordinated Notes ("Notes") in a private offering with the primary purpose of providing capital to the Bank. The Notes are callable by Bancorp or convertible by the investors into common shares. The Notes rank senior in right of repayment to the Debentures. Interest is payable quarterly and may be deferred at Bancorp's option.

On February 15, 2012 Bancorp called $1,026,250 of the Notes. Upon notification of the call, all investors exercised their option to convert to common stock and Bancorp repurchased 69,864 of the 120,296 shares issued.

A summary of the terms of all subordinated debentures at December 31, 2012 is as follows:

	BEO Trust I	BEO Trust II	Callable-Convertible Subordinated Notes
Amount outstanding	$4,124,000	$3,093,000	$3,078,750
Date of original issue	December 17, 2003	March 17, 2005	Dec. 2009 to Mar. 2010
Stated maturity	December 17, 2033	March 17, 2035	December 28, 2014
Interest rate	LIBOR plus 2.85%	LIBOR plus 1.90%	7%
	(3.41% at 12/31/2011)	(2.46% at 12/31/2011)	
Conversion price	N/A	N/A	$8.70 per share

12. Interest **Expense:**

Interest expense for the years ended December 31 is comprised of the following:

	2012	2011
Savings and interest-bearing demand	**$ 292,862**	$ 282,201
Time deposits in excess of $100,000	**228,982**	307,806
Other time deposits	**419,482**	474,227
Interest expense on deposits	**941,326**	1,064,234
Subordinated debentures (Note 11)	**450,524**	484,227
Short-term borrowings	**329**	347
Total interest expense	**$ 1,392,179**	$ 1,548,808

13. Benefit **Plans:**

The Bank has a 401(k) and employee stock ownership plan (ESOP) that covers substantially all employees. Employer contributions are determined annually by the Board of Directors. The ESOP may use employer contributions to purchase Bancorp stock. Shares of Bancorp stock are then credited to plan participants based on annual compensation. All investments of the ESOP are held in trust for the exclusive benefit of participating employees.

Compensation for plan participants is the total wages paid to participants by the Bank for each calendar year, excluding fringe benefits. Dividends on allocated ESOP shares are recorded as a reduction of retained earnings.

Employer contributions charged to expense were $275,537 and $262,567 in 2012 and 2011, respectively. During 2012 and 2011 the plan purchased 13,210 and 4,400 shares of BEO Bancorp stock at a cumulative purchase price of $193,082 and $49,273, respectively. At December 31, 2012 the plan held 68,934 Bancorp shares, all of which were allocated to participants

The Bank is beneficiary of bank-owned life insurance (BOLI) to support life insurance and salary continuation benefits for certain key employees. At December 31, 2012 and 2011, the Bank recorded a salary continuation benefit obligation of $756,687 and $668,274, respectively. During 2012 and 2011 $72,471 and $72,471 was paid in benefits and the amount of expense charged to income was $160,884 and $89,886, respectively.

14. Income **Taxes:**

The provision for income taxes for the years ended December 31 consists of the following:

	2012	2011
Currently payable (refundable):		
Federal	**$ 821,000**	$ 301,000
State	**15,000**	15,000
	836,000	316,000
Deferred:		
Federal	**219,000**	270,000
State	**51,000**	60,000
	270,000	330,000
	$ 1,106,000	$ 646,000

The provision for income taxes results in effective tax rates less than the federal income tax statutory rate. The reasons for the differences are as follows:

	2012	2011
Tax on income at federal statutory rate (34%)	**$ 1,213,121**	$ 903,573
State income tax, net of federal benefit	**9,900**	9,900
Nontaxable interest income, net of allocable interest expense	**(221,475)**	(207,951)
Other, net	**104,454**	(59,522)
	$ 1,106,000	$ 646,000

14. Income **Taxes,** Continued:

The provision for deferred income taxes results from timing differences in the recognition of transactions for financial statement and tax purposes. The nature and tax effects of these differences for the years ended December 31 are as follows:

	2012	2011
Deferred compensation not deducted for tax purposes	**$ (37,045)**	$ (7,227)
Loan origination costs	**15,992**	(2,773)
Loan loss deduction for tax purposes more than provision for financial reporting purposes	**272,237**	320,834
Depreciation and amortization	**(27,802)**	70,384
Other, net	**46,618**	(51,218)
	$ 270,000	$ 330,000

The components of deferred tax assets and liabilities at December 31 are as follows:

	2012	2011
Assets:		
Allowance for loan losses	**$ 458,600**	$ 497,291
Deferred compensation	**316,659**	276,941
Excess book over tax depreciation, amortization and impairment charges	-	3,589
Foreclosed assets basis difference	**142,184**	183,708
Unrealized loss on cash flow hedge instrument	**94,415**	-
Purchased Oregon tax credits - adjusted cost	**218,192**	420,995
Total deferred tax assets	**1,230,050**	1,382,524
Liabilities:		
Unrealized gain on investment securities available-for-sale	**171,798**	218,284
Loan origination costs	**116,493**	99,541
Excess tax over book depreciation, amortization and impairment charges	**13,487**	-
Prepaid expenses	**114,566**	122,914
Federal Home Loan Bank stock dividends	**34,089**	33,763
Total deferred tax liabilities	**450,433**	474,502
Net deferred tax assets	**$ 779,617**	$ 908,022

Bancorp has unused purchased Oregon energy tax credits of $218,000 as of December 31, 2012 expiring through 2016. Based on Bancorp's historical performance, Management believes that these energy tax credits and all net deferred tax assets will be recognized in the normal course of operations and, accordingly, they have not been reduced by a valuation allowance.

15. Financial **Instruments with Off-Balance-Sheet Risk:**

In order to meet the financing needs of its customers, the Bank commits to extensions of credit and issues standby letters of credit. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

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

Financial instruments with off-balance-sheet risk at December 31 are as follows:

	2012	2011
Commitments to extend credit	**$ 45,418,562**	$ 41,126,653
Standby letters of credit and financial guarantees written	**825,000**	870,500

16. **Loans to Related Parties:**

The Bank has granted loans to officers and directors. Such loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated parties. Activity with respect to these loans during the year ended December 31 was as follows:

	2012	2011
Balance, January 1	**$ 1,725,375**	$ 1,651,953
Additions or renewals	**879,763**	1,446,999
Amounts collected or renewed	**(989,067)**	(1,373,577)
Balance, December 31	**$ 1,616,071**	$ 1,725,375

In addition, there were $1,115,166 and $1,100,624 in commitments to extend credit to directors and officers at December 31, 2012 and 2011, respectively, which are included as part of commitments in Note 15.

17. Fair **Value Disclosures of Financial Instruments:**

The following disclosures are made in accordance with provisions of ASC 825. The use of different assumptions and estimation methods could have a significant effect on fair value amounts. Accordingly, the estimates of fair value herein are not necessarily indicative of the amounts that might be realized in a current market exchange.

The estimated fair values of the financial instruments at December 31 are as follows:

	2012		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	**$ 23,101,474**	**$ 23,101,474**	$ 14,603,218	$ 14,603,218
Securities	**19,395,349**	**20,148,461**	27,622,023	27,533,206
Loans, net of allowance for loan losses	**224,776,246**	**231,492,957**	199,907,278	206,530,587
Interest receivable	**3,035,543**	**3,035,543**	2,474,995	2,474,995
Federal Home Loan Bank stock	**549,900**	**549,900**	559,700	559,700
Financial liabilities:				
Deposits	**252,887,782**	**253,521,597**	230,331,319	230,748,601
Cash flow hedge	**236,038**	**236,038**	-	-
Trust Preferred Securities	**7,217,000**	**5,331,780**	7,217,000	4,605,569
Convertible Debentures	**3,078,750**	**3,078,750**	4,105,000	4,105,000
Accrued interest payable	**89,773**	**89,773**	100,225	100,225

Cash and Cash Equivalents – The fair value approximates carrying amount.

Securities – Fair value is based on quoted market prices. If a quoted market price is not available, fair value is estimated using quoted market prices from similar securities.

Loans – Fair value of fixed-rate 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. Variable rate loans not at contractual floors have carrying amounts that are a reasonable estimate of fair value. Impaired loans' fair values are estimated primarily at collateral values and consider credit risk.

Deposits – Fair value of demand, interest-bearing demand and savings deposits is the amount payable on demand at the reporting date. Fair value of time deposits is estimated using the interest rates currently offered for the deposits of similar remaining maturities. The estimated fair values of deposits do not take into account the benefit that results from low-cost funding such deposits provide.

17. **Fair Value Disclosures of Financial Instruments,** Continued:

Subordinated debentures – The fair value is estimated by discounting future cash flow at rates currently available for debt with similar terms and maturities.

Off-Balance-Sheet Financial Instruments – The carrying amount and fair value are based on fees charged for similar commitments and are not material.

The following table presents the Company's fair value hierarchy for those assets and liabilities measured at fair value:

	Fair Value Measurements Using				
	Total	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)	Total Period Losses Included in Earnings
December 31, 2012					
Recuring items:					
Cash flow hedge instrument	**$ (236,038)**	**$ -**	**$ (236,038)**	**$ -**	
Investment securities available for sale	**14,299,138**	**-**	**14,299,138**	**-**	
Total items measured at fair value on a recurring basis	**$14,063,100**	**$ -**	**$14,063,100**	**$ -**	
Non-recurring items:					
Impaired loans net of reserves	**$ 3,001,921**	**$ -**	**$ -**	**$ 3,001,921**	**$ 484,754**
Foreclosed assets	**862,010**	**-**	**-**	**862,010**	**-**
Total items measured at fair value on a non-recurring basis	**$ 3,863,931**	**$ -**	**$ -**	**$ 3,863,931**	
December 31, 2011					
Recuring items:					
Investment securities available for sale	$22,131,723	$ -	$22,131,723	$ -	
Non-recurring items:					
Impaired loans net of reserves	$ 2,712,579	$ -	$ -	$ 2,712,579	$ 902,067
Foreclosed assets	1,471,800	-	-	1,471,800	221,165
Total assets measured at fair value on a non-recurring basis	$ 4,184,379	$ -	$ -	$ 4,184,379	

17. Fair Value Disclosures of Financial Instruments, Continued

The fair value represents management's best estimates based on a range of methodologies and assumptions. For loans with doubt as to collectability and foreclosed assets expected cash flows are discounted using an appropriate rate considering the time of collection, credit risk, and the discount for the uncertainty of the flows. The value of collateral is also considered.

A roll-forward of the assets measured at Fair Value Using Unobservable Inputs (Level III) is as follows:

Fair Value Measurement Using Unobservable Inputs (Level III)

	Impaired loans net of reserves	Foreclosed assets	Total
Beginning balance 12/31/11	$ 2,712,579	$ 1,471,800	$ 4,184,379
Net unrealized losses	(484,754)	-	(484,754)
Net realized gains (losses)	(485,412)	7,699	(477,713)
Additions, collections and deletions, net	1,326,118	-	1,326,118
Transfers between Level III at fair value	(66,610)	66,610	-
Sales	-	(684,099)	(684,099)
Ending balance 12/31/12	$ 3,001,921	$ 862,010	$ 3,863,931

18. Regulatory Matters:

Bancorp and the Bank are subject to the regulations of certain federal and state agencies and receive periodic examinations by those regulatory authorities. In addition, Bancorp and the Bank are subject to various regulatory capital requirements administered by the Federal Reserve Board ("FRB") and Federal Deposit Insurance Corporation ("FDIC"). 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 financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, banks must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Bancorp's and the Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require Bancorp and the Bank to maintain minimum amounts and ratios (set forth in the following table below) of Total and Tier I capital to risk-weighted assets, and of Tier I capital to leverage assets, all as defined in the regulations. Management believes, as of December 31, 2012, Bancorp and the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2012, the most recent notification from the FRB and FDIC categorized Bancorp and the Bank as well capitalized. 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 are no conditions or events from that date through March 8, 2013 that management believes have changed the institution's category.

18. Regulatory Matters, Continued:

Bancorp's and the Bank's actual capital amounts (in thousands) and ratios are also presented in the following table.

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2012:						
Total capital (to risk-weighted assets)						
BEO Bancorp	**$ 29,053**	**12.65%**	**$ 18,367**	**8%**	**N/A**	**N/A**
Bank of Eastern Oregon	**31,552**	**13.74%**	**18,367**	**8%**	**22,953**	**10%**
Tier I capital (to risk-weighted assets)						
BEO Bancorp	**26,065**	**11.35%**	**9,184**	**4%**	**N/A**	**N/A**
Bank of Eastern Oregon	**29,060**	**12.66%**	**9,184**	**4%**	**13,776**	**6%**
Tier I capital (to leverage assets)						
BEO Bancorp	**26,065**	**9.08%**	**11,480**	**4%**	**N/A**	**N/A**
Bank of Eastern Oregon	**29,060**	**10.13%**	**11,480**	**4%**	**14,350**	**5%**
As of December 31, 2011:						
Total capital (to risk-weighted assets)						
BEO Bancorp	$ 26,662	12.85%	$ 16,600	8%	N/A	N/A
Bank of Eastern Oregon	30,365	14.63%	16,600	8%	$ 20,750	10%
Tier I capital (to risk-weighted assets)						
BEO Bancorp	23,044	11.11%	8,300	4%	N/A	N/A
Bank of Eastern Oregon	27,771	13.38%	8,300	4%	12,450	6%
Tier I capital (to leverage assets)						
BEO Bancorp	23,044	8.82%	10,449	4%	N/A	N/A
Bank of Eastern Oregon	27,771	10.63%	10,449	4%	13,075	5%

19. Parent **Company Financial Information:**

Financial information for BEO Bancorp is presented below:

BALANCE SHEETS

	December 31	
	2012	**2011**
Assets:		
Cash, deposited with the Bank	**$ 350,046**	$ 164,573
Investments in:		
Bank subsidiary	**29,524,548**	28,472,914
Nonbank subsidiaries (Trusts)	**217,000**	217,000
Deferred Tax Asset	**94,415**	-
Subordinated debt issuance costs, net of amortization	**20,000**	30,000
	$ 30,206,009	$ 28,884,487
Liabilities and stockholders' equity:		
Liabilities:		
Accrued interest payable	**$ 7,152**	$ 8,171
Unrealized loss on cash flow hedge instrument	**236,038**	-
Subordinated debt	**10,295,750**	11,322,000
Total liabilities	**10,538,940**	11,330,171
Stockholders' equity:		
Common stock	**2,661,105**	2,408,945
Surplus	**1,806,927**	1,690,193
Retained earnings and accumulated other comprehensive income	**15,199,037**	13,455,178
Total stockholders' equity	**19,667,069**	17,554,316
Total liabilities and stockholders' equity	**$ 30,206,009**	$ 28,884,487

19. Parent **Company Financial Information,** Continued:

STATEMENTS OF INCOME

	Year Ended December 31	
	2012	**2011**
Cash dividends from Bank	**$ 486,275**	$ 368,847
Less:		
Interest expense	**(448,193)**	(484,227)
Professional fees and administrative expenses	**(94,412)**	(86,587)
Amortization of subordinated debt issuance costs	**(10,000)**	(10,000)
Income (loss) before equity in undistributed earnings of the Bank	**(66,330)**	(211,967)
Equity in undistributed earnings of Bank	**2,308,326**	1,934,534
Credit for income taxes	**220,000**	289,000
Net income	**$ 2,461,996**	$ 2,011,567

STATEMENTS OF CASH FLOWS

	Year Ended December 31	
	2012	**2011**
Operating activities:		
Net income	**$ 2,461,996**	$ 2,011,567
Adjustments to reconcile net income to net cash provided by operating activities:		
Undistributed earnings of the Bank	**(2,308,326)**	(1,934,534)
Amortization of subordinated debt issuance costs	**10,000**	10,000
Change in other assets and liabilities	**(1,637)**	1,068
Net cash provided by operating activities	**162,033**	88,101
Investing activities:		
Investment in subsidiaries	**1,167,071**	-
Financing activities:		
Retirement of subordinated debt	**(1,026,250)**	-
Issuance of Common Stock	**1,046,845**	-
Repurchase of common stock	**(677,951)**	-
Dividends paid	**(486,275)**	(368,848)
Net cash provided by financing activities	**(1,143,631)**	(368,848)
Net increase (decrease) in cash	**185,473**	(280,747)
Cash, beginning of year	**164,573**	445,320
Cash, end of year	**$ 350,046**	$ 164,573

20. Earnings Per Share:

Earnings per share (EPS) are computed on the basis of the weighted average number of shares outstanding during each year. Diluted EPS includes the effect from the potential issuance of common stock associated with the Subordinated Callable-Convertible Notes (Note 11).

The reconciliation of the numerators and denominators of the basic and diluted EPS calculations is as follows for the fiscal years ended December 31:

	2012	2011
Numerator:		
Net earnings	**$ 2,461,996**	$ 2,011,567
Adjustment for interest expense on convertible notes, net of tax effect	**129,308**	5,196.00
Net earnings, adjusted	**$ 2,591,304**	$ 2,016,763
Denominator:		
Basic weighted average shares	**966,332**	922,118
Dilution for convertible notes	**99,011**	1,467
Diluted weighted average shares	**1,065,343**	923,585
Basic EPS	**$2.55**	$2.18
Diluted EPS	**$2.43**	$2.18