COMMUNITY BANCSHARES INC /DE/
Form 10-K
April 14, 2004

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS

PURSUANT SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended December 31, 2003

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

For the transition period from ______ to ______

Commission file number 000-16461

Community Bancshares, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware **(State or Other Jurisdiction of** **Incorporation or Organization)**	**63-0868361** **(I.R.S. Employer Identification No.)**
68149 Main Street **Blountsville, Alabama** **(Address of Principal Executive Offices)**	**35031** **(Zip Code)**

Registrant s telephone number, including area code (205) 429-1000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
None	**None**

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $.10 Par Value Per Share

(Title of Class)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ¨ No x

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

The aggregate market value of Community Bancshares, Inc. s common stock, par value $.10 per share, held by non-affiliates on March 18, 2004 was $34.0 million, based on a price of $4.50 per share, which was the price at which the common stock was last sold in what Community Bancshares, Inc. believes to be arm s length transactions on or prior to June 30, 2003.

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date.

As of March 18, 2004, there were 8,376,163 shares of the common stock, par value $.10 per share, of Community Bancshares, Inc., issued and outstanding.

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IMPORTANT INFORMATION ABOUT THIS REPORT

In this report, the words Company, we, us and our refer to the combined entities of Community Bancshares, Inc., Community Bank, 1 Community Credit Corporation, Community Insurance Corp., Southern Select Insurance, Inc., Community Appraisals, Inc., and Community Funding Corporation.

The words Community Bancshares, Community Bank, Community Credit, Community Insurance, Southern Select, Community Appraisals, Community Funding refer to each of those entities individually.

SPECIAL CAUTIONARY NOTICE

REGARDING FORWARD-LOOKING STATEMENTS

Certain statements made or incorporated by reference in this report are forward-looking statements within the meaning of, and subject to the protections of, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act.

Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, anticipations, assumptions, estimates, intentions, and future performance, and involve known and unknown risks, uncertainties and other factors, many of which may be beyond our control, and which may cause our actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by the forward-looking statements.

All statements other than statements of historical fact are statements that could be forward-looking statements. You can identify these forward-looking statements through our use of words such as may, will, anticipate, hope, project, assume, should, indicate, would contemplate, expect, estimate, continue, plan, point to, could, intend, seek, target, and other similar words and expressions of forward-looking statements may not be realized due to a variety of factors, including, without limitation:

- future economic or business conditions;
- governmental monetary and fiscal policies, as well as legislative and regulatory changes, including changes in tax laws and regulations;
- the risks of changes in interest rates on the levels, composition and costs of deposits, loan demand, and the values of loan collateral, securities, and interest sensitive assets and liabilities;
- interest rate risks and credit risks of borrowers;

the effects of competition from a wide variety of local, regional, national and other providers of financial, investment and insurance services;

the failure of assumptions underlying the establishment of the allowance for loan losses and other estimates, and the uncertainty and costs of litigation;

the risks of mergers, acquisitions and divestures, including, without limitation, the related time and costs of implementing such transactions, and the possible failure to achieve expected gains, revenue growth and/or expense savings expected from such transactions;

changes in accounting policies, rules and practices;

difficulties with, or changes in the cost or effectiveness of technology and/or products;

the effects of war or other conflict, acts of terrorism or other catastrophic events that affect general economic conditions; and

other factors and other information discussed in this report, as well as other factors and risks described in any of our other reports that we make with the SEC under the Exchange Act.

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All written or oral statements that are made by or are attributable to us are expressly qualified in their entirety by this cautionary notice. We have no obligation and do not undertake to update, revise or correct any of the forward-looking statements after the date of this report, or after the respective dates on which such statements otherwise are made.

PART I

ITEM 1. BUSINESS.

General

Our company is made up of the following entities:

- Community Bancshares, Inc., a Delaware bank holding company that owns 100% of Community Bank and Community Bank s subsidiaries;
- Community Bank, a community-focused Alabama commercial bank;
- 1st Community Credit Corporation, a finance company subsidiary of Community Bank;
- Community Insurance Corp., a subsidiary of Community Bank that is as an insurance agency for the sale of title, property, casualty and life insurance to individuals and businesses;
- Southern Select Insurance, Inc., a subsidiary of Community Insurance that brokers agricultural, commercial and personal insurance products;
- Community Appraisals, Inc., a subsidiary of Community Bank that provides appraisal services in connection with the lending activities of Community Bank and its subsidiaries, but ceased operations in late 2003; and
- Community Funding Corporation, a subsidiary of Community Bancshares, Inc. formed on December 30, 2003 to purchase and maintain certain nonperforming assets of Community Bank.

As of December 31, 2003, we had total consolidated assets of approximately $558.6 million, total deposits of approximately $453.9 million, total consolidated liabilities, including deposits, of approximately $523.2 million, and consolidated stockholders equity of approximately $35.3 million.

Our principal executive offices, which also serve as the principal executive offices of Community Bank, Community Appraisals and Community Funding, are located at 68149 Main Street, Blountsville, Alabama 35031, and our telephone number at that address is (205) 429-1000. The principal executive offices of Community Credit are located at 587 Highway 31 N.W., Suite A, Hartselle, Alabama 35640, and the telephone number at that address is (256) 751-2031. The principal executive offices of Community Insurance and Southern Select are located at 401 Holmes Avenue, Huntsville, Alabama 35801, and the telephone number at that address is (256) 533-5600.

Community Bancshares

Community Bancshares is a Delaware corporation that is registered as a bank holding company with the Board of Governors of the Federal Reserve System, or the Federal Reserve, under the Bank Holding Act of 1956. Community Bancshares was organized in 1983 and commenced business in 1985.

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Our Commercial Banking Business

We conduct our commercial banking operations through Community Bank. Community Bank is an Alabama banking corporation founded in 1923. Community Bank is a member of the FDIC and its deposits are insured by the FDIC.

Community Bank provides a broad range of commercial and retail banking services through 20 locations in nine counties in Alabama. Community Bank offers a wide range of commercial and retail banking services, which principally include checking transaction accounts, and personal and commercial loans to customers in our target market area. Community Bank seeks to provide superior service to its customers and to become a vital component of each of the communities that it serves. We believe that the retail nature of Community Bank s commercial banking operations allows for diversification of customers and that our loans to businesses are not concentrated in any one industry.

Community Bank s lending activities include commercial, real estate and consumer loans. The majority of Community Bank s loans are to individuals and small to mid-sized businesses in Alabama. Our commercial loan services include term loans, lines of credit and agricultural loans. We provide a broad range of short- to medium-term commercial loans, both secured and unsecured, to various local businesses for working capital, business expansion and the purchase of equipment and machinery. Our real estate lending activities include fixed and adjustable rate residential mortgage loans, construction loans, second mortgages, home improvement loans and home equity lines of credit. Our consumer lending services include loans for automobiles, recreation vehicles and boats, as well as unsecured personal loans and loans secured by deposit accounts.

Community Bank operates primarily in small non-urban communities. As of December 31, 2003, Community Bank operated 18 full service offices and two paying and receiving offices located in Wal-Mart® stores, which primarily open deposit accounts, cash checks and receive deposits and loan payments.

For the year ended December 31, 2003, Community Bank had pretax losses of approximately $19.6 million. During the fiscal years 2001 and 2002, Community Bank had pretax income of approximately $801,000 and $3.2 million, respectively. Our loan portfolio, which consisted of 56.6% of our assets at December 31, 2003, 63.8% at December 31, 2002 and 69.0% at December 31, 2001, continues to represent our largest earning asset. As of December 31, 2003, we had total commercial banking loans of $316.2 million.

Our Other Operations

Non-Traditional Banking Operations

1st Community Credit Corporation operates 12 finance company offices in Limestone, Madison, Morgan, Blount, Cullman, Marshall, Etowah, DeKalb and Walker Counties, Alabama, primarily in local communities where Community Bank does not operate. Community Credit provides smaller loans to a market segment traditionally not pursued by Community Bank. These loans typically involve greater risk and generate higher yields than standard commercial bank loans. We believe that, by conducting this business, we are establishing a business presence and a customer base in communities where Community Bank may at some point commence full-scale commercial banking operations. For the year ended December 31, 2003, Community Credit had pretax income of $933,000. For the years ended December 31, 2002 and December 31, 2001, we had approximately $380,000 and $(2.4 million), respectively, in pretax income (losses) from the operations of Community Credit. At December 31, 2003, our loan portfolio at Community Credit was $31.2 million, representing 5.6% of our total assets. At December 31, 2002 and 2001, our loan portfolio at Community Credit was $27.9 million and $24.8 million, representing 4.9% and 3.4% of our total assets, respectively.

Insurance Operations

Community Insurance Corp. serves as an agency in the sale of title, property, casualty and life insurance products to individuals and businesses in the Huntsville metropolitan area. Community Insurance owns 100% of Southern Select Insurance, Inc., a managing general agency in Huntsville that brokers agricultural, commercial and personal insurance products. For the years ended December 31, 2003, December 31, 2002, and December 31, 2001, we had approximately $(486,000), $154,000 and $(1.6 million), respectively, in pretax income (losses) from our insurance operations.

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Appraisal Operations

Community Appraisals, Inc. provides appraisal services in connection with the lending activities of Community Bank and Community Credit. For the years ended December 31, 2003, December 31, 2002, and December 31, 2001, our appraisal business generated approximately $(6,000), $57,000 and $92,000, respectively, in pretax income (loss). At this time, Community Appraisals is inactive, and Community Bank is outsourcing its appraisal needs to third parties.

Asset Quality Improvement

Community Funding Corporation was formed in December 2003 for the purpose of purchasing and maintaining certain of Community Bank s nonperforming assets in order to improve Community Bank s asset quality. Community Funding conducted no business in 2003.

Our Market Area

Community Bank currently has 20 branches in nine counties, most of which are situated in northern Alabama. We serve customers in nine counties in north Alabama Blount, Cullman, DeKalb, Etowah, Lauderdale, Limestone, Madison, Marshall and Morgan Counties; two counties in northwest Alabama Marion and Winston Counties; and two counties in southwest Alabama Marengo and Perry Counties. We have branch offices in Blount, Lauderdale, Limestone, Madison, Marengo, Marion, Perry and Winston Counties, Alabama. We have focused on those market areas between the Birmingham and Huntsville metropolitan areas, where significant growth and economic change has transpired over the last decade.

Community Bank s primary market area is Blount County, which was added to the Birmingham metropolitan area in 1983. The Birmingham Metropolitan Statistical Area, or MSA, consists of seven counties and is home to approximately 1.1 million people, representing the most populous MSA in the State of Alabama. Once known as the South s largest manufacturing center, Birmingham previously relied heavily on both the steel and manufacturing industries. Manufacturing remains an important part of Birmingham s economy but the economy is becoming more diverse, and, according to the Birmingham Regional Chamber of Commerce, the healthcare, banking and professional services industries are its leading economic sectors and largest employers.

Birmingham is home to one of the top healthcare sectors in the Southeast, anchored by the University of Alabama at Birmingham Medical School. As described in the Thomas Banking Dictionary, four of the largest U.S. banks in the Southeast maintain their headquarters in Birmingham. With banking assets totaling over $160 billion, Birmingham, according to the Thomas Banking Dictionary, is among the nation s top ten cities in total banking assets. Currently, six Fortune 500 companies maintain operations in the Birmingham MSA.

Community Bank also has customers in six counties Cullman, Lauderdale, Limestone, Madison, Marshall and Morgan Counties which are proximate to or within the Huntsville MSA, currently one of Alabama s fastest growing metropolitan areas. Huntsville is the State s second largest MSA with approximately 850,000 people residing within a 50 mile radius of the city and four million people residing within a 100 mile radius. It has been identified by the U.S. Census Bureau figures, March 2000, as one of the Top 50 fastest growing metropolitan areas in the United States and consistently ranks among the top three wealthiest counties in the Southeast in average annual wages according to the Alabama Regional

Chamber of Commerce.

Huntsville possesses a diverse economic base and is home to numerous industries, including technology, space and defense, manufacturing, and retail and service. Huntsville is home to numerous centers of global excellence, including the Cummings Research Park (over 22,500 employees and 220 companies), the NASA Marshall Space Flight Center, and the US Army Redstone Arsenal. Currently, 20 Fortune 500 companies and 50 publicly traded companies maintain operations in the Huntsville metropolitan area.

Community Bank has branches in Marion, Lauderdale and Winston Counties, located in northwest Alabama, near the Mississippi border. These counties are economically driven by manufacturing and furniture production. Community

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Bank also operates in Marengo and Perry Counties, located in southwest Alabama, where manufacturing, catfish farming, livestock and the timber industry are important components of the local economy. These are relatively low growth areas, with income levels that are below Alabama averages.

In the first half of 2002, we sold two branch offices of Community Bank located in Pulaski, Tennessee, and eight branch offices located in Marshall and DeKalb Counties, Alabama, two of which were paying and receiving offices located in Wal-Mart stores.

Competition

The banking business in Alabama is highly competitive with respect to loans, deposits and other financial services and is dominated by a number of major banks and bank holding companies that have offices and affiliates operating over wide geographic areas, and that have greater resources at their disposal than we do. We compete for deposits, loans and other business with these institutions as well as with other types of financial services entities, including savings and loan associations, credit unions, securities and mutual fund firms, mortgage companies, and insurance companies. Many of the major commercial banks operating in or around Community Bank s service areas offer services such as investment and trust services, which we do not offer.

Our competitive environment has been and will continue to be materially affected by the enactment of the Gramm-Leach-Bliley Financial Services Modernization Act of 1999. This law authorized a bank holding company that possesses a prescribed amount of capital and meets other criteria to become a financial holding company, which enables it to then engage in investment banking, insurance underwriting and the sale of insurance, as well as any other activity that federal regulators view as financial in nature. We may face greater competition as more financial holding companies enter our market area and offer a more diverse line of financial products and consolidated financial services than we are able to offer.

In addition, during 2002, Community Bank sold ten of its branch offices located in Pulaski, Tennessee, and DeKalb and Marshall Counties, Alabama, to competing third party commercial banks. In connection with those sales, we entered into non-competition agreements that impose the following restrictions:

- Community Bank may not directly or indirectly develop, own or operate any physical location offering financial services or products within a 25 mile radius of Pulaski, Tennessee, until January 23, 2004, other than those locations of Community Bank that were operating as of January 23, 2002;
- Community Bank may not own or operate any commercial bank branch within DeKalb County, Alabama, until May 3, 2004;
- Community Bank may not own or operate any commercial bank branch within Marshall County, Alabama, until May 31, 2004, except that we may operate within the city limits of Guntersville, Alabama; and
- Community Bank may not directly compete for or solicit any deposits or loans that were the subject of these sales.

We presently do not have any offices in Guntersville, Alabama.

As a result of these non-competition agreements, we may be temporarily unable to compete in market areas that we find desirable for the next six months.

Seasonality

The Company s business is not seasonal in nature.

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Customer Concentration

For each of the years ended December 31, 2003, 2002 and 2001, the Company did not, and the Company presently does not expect that, for the year ended December 31, 2004, it will, derive more than 10% of its revenues, on a consolidated basis, from any one customer.

Our Regulatory Environment

The banking and financial services industry is extensively regulated under both federal and state law. The following discussion summarizes certain statutes, rules and regulations affecting our business and operations. This summary is qualified in its entirety by reference to the statutory and regulatory provisions referred to below and elsewhere and is not intended to be an exhaustive description of the statutes or regulations applicable to us. Changes in the laws and regulations that apply to us can affect our operations in substantial and unpredictable ways. We cannot accurately predict whether legislation will be enacted, and, if enacted, the ultimate effect that it or any implementing regulations will have on our business, financial condition or results of operations.

The following summary describes our regulatory environment in the absence of any restrictive memoranda, orders or agreements with our regulators and therefore is further subject to, and does not address, the regulatory restrictions to which we are currently subject. You should refer to and carefully review these restrictions, which are described below in this report. To the extent that the limitations imposed by those regulatory restrictions on our business activities are different than as described in this summary, then the regulatory restrictions govern.

Supervision, regulation, and examination of holding companies and banks by bank regulatory agencies are intended primarily for the protection of depositors rather than holders of our securities, including our preferred stock and our common stock.

Holding Company Regulation

General

Community Bancshares is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended, or the BHC Act, and is subject to supervision, examination, and reporting by the Federal Reserve. The State of Alabama does not regulate bank holding companies. Community Bancshares is required to file with the Federal Reserve periodic reports and any additional information as the Federal Reserve may require. The Federal Reserve regularly examines Community Bancshares and may examine its subsidiaries.

Investment Activities

The BHC Act requires prior Federal Reserve approval for, among other things:

- the acquisition by a bank holding company of direct or indirect ownership or control of more than 5% of the voting shares or substantially all of the assets of any bank; and

- a merger or consolidation of a bank holding company with another bank holding company.

The Change in Bank Control Act and Federal Reserve regulations also generally require a notice and prior action thereon if anyone not subject to the BHC Act application acquires 10% or more of a bank s or its parent holding company s securities where the bank or holding company has a class of securities registered under the Exchange Act.

A bank holding company may acquire direct or indirect ownership or control of voting shares of any company that is engaged directly or indirectly in banking, managing or controlling banks, or performing services for its authorized subsidiaries. A bank holding company may also engage in or acquire an interest in a company that engages in activities that the Federal Reserve has determined by regulation or order to be so closely related to banking as to be a proper incident to those activities.

In November 1999, Congress enacted the Gramm-Leach-Bliley Financial Services Modernization Act of 1999, or the GLB Act, which made substantial revisions to the statutory restrictions separating banking activities from certain other financial activities. Under the GLB Act, bank holding companies that are well-capitalized and well-managed and meet other conditions can elect to become financial holding companies. Financial holding companies and their subsidiaries are permitted to acquire or engage in previously impermissible activities such as insurance underwriting, securities underwriting and distribution, travel agency activities, board insurance agency activities, merchant banking, and other activities that the Federal Reserve determines to be financial in nature or complementary to those activities. In addition, under the merchant banking authority added by the GLB Act and Federal Reserve regulations, financial holding companies are authorized to invest in companies that engage in activities that are not financial in nature, as long as the financial holding company makes its investment with the intention of limiting the investment in duration, does not manage the company on a day-to-day basis, and the investee company does not cross-market with any of the financial holding company s controlled depository institutions. Financial holding companies continue to be subject to the overall oversight and supervision of the Federal Reserve, but the GLB Act applies the concept of functional regulation to the activities conducted by subsidiaries. For example, insurance activities would be subject to supervision and regulation by state insurance authorities. Community Bancshares has not sought approval to become a financial holding company and presently has no intention of doing so in the foreseeable future.

Source of Financial Strength

Federal Reserve policy requires a bank holding company to act as a source of financial and managerial strength to its subsidiary banks. This means that a bank holding company must be prepared to use available resources to provide adequate capital funds to its bank subsidiaries during periods of financial stress and must have sufficient financial flexibility and capital-raising capacity to provide ongoing support to the banks. In addition, under the Financial Institutions Reform, Recovery and Enforcement Act of 1989, or FIRREA, if a bank holding company has more than one bank or thrift subsidiary, each of the bank holding company s subsidiary depository institutions are responsible for any losses to the FDIC as a result of an affiliated depository institution s failure. As a result, a bank holding company may be required to loan money to its subsidiaries in the form of capital notes or other instruments which qualify as capital under regulatory rules. Any loans from a bank holding company to its subsidiary banks likely will be unsecured and subordinated to the bank s depositors and perhaps to other creditors of that bank.

Transactions With Affiliates

Community Bancshares is a legal entity separate and distinct from Community Bank. Various legal limitations restrict Community Bank from lending or otherwise supplying funds to Community Bancshares or its other affiliates. Section 23A of the Federal Reserve Act limits a bank s covered transactions, which include extensions of credit with any affiliate, to 10% of the bank s capital and surplus. All covered and exempt transactions between a bank and its affiliates must be on terms and conditions consistent with safe and sound banking practices, and banks and their subsidiaries are prohibited from purchasing low-quality assets from the bank s affiliates. Finally, all of a bank s extensions of credit to an affiliate must be appropriately secured by acceptable collateral, generally United States government or agency securities.

Section 23B of the Federal Reserve Act requires that covered and exempt transactions among affiliates be on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to the bank or its subsidiary, as those prevailing at the time for transactions with unaffiliated companies.

Bank Regulation

General

Community Bank is an Alabama bank whose deposits are insured by the FDIC. Community Bank is subject to regulation and examination by the Alabama Superintendent of Banks and by the FDIC. The Alabama Superintendent of Banks and the FDIC regulate and examine all of Community Bank s operations, including its overall financial condition and resources, loan loss reserves, the quality of its loan portfolio, mortgages, payments of dividends, interest rates charged, the establishment of branches, the actions of its directors and management, the investment of its funds, and compliance with its charter and the law.

The powers of Alabama-chartered banks include provisions designed to provide these banks with competitive equality to the powers of national banks. In addition, the GLB Act permits banks to engage in financial activities through subsidiaries in a manner similar to financial holding companies.

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Dividends

Various statutes limit Community Bank s ability to pay dividends, extend credit or otherwise supply funds to Community Bancshares. Dividends from Community Bank historically have been Community Bancshares primary source of funds for servicing debt and paying cash dividends to our stockholders.

Under Alabama law, a bank may not pay a dividend in excess of 90% of its net earnings until its surplus is equal to at least 20% of its capital. The prior approval of the FDIC and/or the Alabama Superintendent is required if the total of all dividends declared by a bank in any calendar year will exceed the sum of that bank s net earnings for the year and its retained net earnings for the preceding two calendar years, less any required transfers to surplus. In addition, a bank may not pay dividends from its surplus without the prior approval of the Superintendent. During 2002 and 2003, Community Bank paid no cash dividends to Community Bancshares. As of December 31, 2003, Community Bank could not have declared or paid any dividend without prior approval of the Superintendent of Banks.

In addition, Community Bancshares and Community Bank are subject to various regulatory policies and requirements that affect the payment of dividends, including requirements to maintain adequate capital. The appropriate federal and state regulatory authorities are authorized to determine, based on the financial condition of a bank or bank holding company, that the payment of dividends would be an unsafe or unsound practice and to prohibit payment of those dividends. The FDIC and the Alabama Superintendent have indicated that paying dividends that deplete a bank s capital base to an inadequate level would be an unsound and unsafe banking practice.

As to Community Bancshares, the Federal Reserve may prohibit the payment of dividends to our stockholders if it determines that the payment would constitute an unsafe or unsound practice. The Federal Reserve s position is that a bank holding company should not pay dividends if it is experiencing earnings weaknesses or other financial pressures and should not pay dividends that exceed its net income, that are inconsistent with its capital position or that could only be funded in ways that weaken its financial health, such as by borrowing or selling its assets. In addition, a bank holding company must not pay dividends if such payment would affect its ability to provide adequate financial support for its subsidiary banks. The Federal Reserve has restricted Community Bancshares from declaring or paying any dividends or repurchasing its capital stock without prior Federal Reserve approval.

Safety and Soundness

The FDIC has adopted the Federal Financial Institutions Examination Council s, or the FFIEC, internal rating system for assessing the soundness of financial institutions on a uniform basis and for identifying those institutions requiring special supervisory attention. Each financial institution is assigned a confidential composite CAMELS rating based on an evaluation and rating of the following six components of an institution s financial condition and operations:

Capital adequacy;

Asset quality;

Management;

Earnings;

Liquidity; and

Sensitivity to market risk.

For most institutions, the FFIEC has indicated that market risk primarily reflects exposures to changes in interest rates. When regulators evaluate this component, consideration is expected to be given to the sensitivity of the financial institution s earnings or the economic value of its capital to adverse changes in interest rates, foreign exchange rates, commodity prices, or equity prices; management s ability to identify, measure, monitor and control exposure to market risk; the nature and complexity of interest rate risk exposure arising from non-trading positions; and the adequacy of its capital and earnings in relation to its level of exposure.

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Capital Regulations

The federal bank regulatory agencies have adopted risk-based capital guidelines for bank holding companies and banks. The guideline for a minimum ratio of capital to risk-weighted assets, including certain off-balance-sheet activities, such as standby letters of credit, is 8.0%. At least half of the total capital must consist of Tier 1 Capital, which includes common equity, retained earnings and a limited amount of qualifying preferred stock, less goodwill. The remainder may consist of Tier 2 Capital, which includes non-qualifying preferred stock, qualifying subordinated, perpetual, and/or mandatory convertible debt, term subordinated debt, intermediate term preferred stock and up to 45.0% of the pretax unrealized holding gains on available-for-sale equity securities with readily determinable market values that are prudently valued, and a limited amount of any loan loss allowance.

All bank holding companies and banks are expected to hold capital commensurate with the level and nature of their risks, including the volume and severity of their problem loans. The federal agencies have established minimum leverage ratio guidelines for bank holding companies, national banks, and state banks, which provide for a minimum leverage ratio of Tier 1 Capital to adjusted average quarterly assets equal to 3.0%, plus an additional cushion of 1.0% to 2.0% if the institution has less than the highest regulatory rating. The guidelines also provide that institutions experiencing internal growth or making acquisitions will be expected to maintain capital positions substantially above the minimum supervisory levels. Higher capital may be required in individual cases, depending upon a bank holding company s risk profile. Lastly, the Federal Reserve s guidelines indicate that the Federal Reserve will continue to consider a Tangible Tier 1 Leverage Ratio, calculated by deducting all intangibles, in evaluating proposals for expansion or new activity.

FDICIA requires the federal banking agencies to take prompt corrective action in respect of depository institutions that do not meet minimum capital requirements. FDICIA established five capital tiers:

- well capitalized;
- adequately capitalized;
- undercapitalized;
- significantly undercapitalized; and
- critically undercapitalized.

A depository institution s capital tier will depend upon how its capital levels compare to various measures and certain other factors, as established by regulation. The capital measures used by the federal banking regulators are:

- the Total Capital ratio, which is the ratio of the total of Tier 1 Capital and Tier 2 Capital to total risk-weighted assets;
- the Tier 1 Capital ratio; and

the Leverage Ratio.

Under these regulations, a bank will be:

- well capitalized if it has a Total Capital ratio of 10.0% or greater, a Tier 1 Capital ratio of 6.0% or greater, and is not subject to any written agreement, order, capital directive, or prompt corrective action directive by a federal bank regulatory agency to meet and maintain a specific capital level for any capital measure;

- adequately capitalized if it has a Total Capital ratio of 8.0% or greater, a Tier 1 Capital ratio of 4.0% or greater, and a leverage ratio of 4.0% or greater or 3.0% in some circumstances and is not well capitalized;

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undercapitalized if it has a Total Capital ratio of less than 8.0% or a Tier 1 capital ratio of less than 4.0%, or 3.0% in some circumstances;

significantly undercapitalized if it has a Total Capital ratio of less than 6.0%, a Tier 1 Capital ratio of less than 3.0%, or a leverage ratio of less than 3.0%; or

critically undercapitalized if its tangible equity is equal to or less than 2.0% of average quarterly tangible assets.

The following table sets forth the capital information of Community Bancshares and Community Bank as of December 31, 2003:

CAPITAL ADEQUACY RATIOS

	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
			(Dollars in thousands)			
Total risk based capital to risk weighted assets:						
Consolidated	$ 48,423	14.52%	$ 26,688	8.00%	$ 33,360	10.00%
Community Bank	46,919	14.10	26,626	8.00	33,282	10.00
Tier 1 capital to risk weighted assets:						
Consolidated	44,127	13.23	13,344	4.00	20,016	6.00
Community Bank	42,633	12.81	13,313	4.00	19,969	6.00
Tier 1 capital to average assets:						
Consolidated	44,127	7.96	22,172	4.00	27,715	5.00
Community Bank	42,633	7.72	22,086	4.00	27,608	5.00

Community Reinvestment Act

Community Bancshares and Community Bank are subject to the Community Reinvestment Act, or the CRA, and the federal banking agencies related regulations. Under the CRA, all banks and thrifts have a continuing and affirmative obligation, consistent with their safe and sound operation, to help meet the credit needs for their entire communities, including low- and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions, nor does it limit an institution s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA requires a depository institution s primary federal regulator, in connection with its examination of the institution, to assess the institution s record of assessing and meeting the credit needs of the community served by that institution, including low- and moderate-income neighborhoods. The regulatory agency s assessment of the institution s record is made available to the public. Further, such assessment is required of any institution that has applied to:

charter a bank;

obtain deposit insurance coverage for a newly-chartered institution;

establish a new branch office that accepts deposits;

relocate an office; or

merge or consolidate with, or acquire the assets or assume the liabilities of, a federally regulated financial institution.

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A less than satisfactory CRA rating will slow, if not preclude expansion of banking activities.

Current CRA regulations rate institutions based on their actual performance in meeting community credit needs. CRA performance is evaluated by the FDIC, Community Bank s primary federal regulator using a lending test, an investment test, and a service test. The FDIC also will consider:

- demographic data about the community;
- the institution s capacity and constraints;
- the institution s product offerings and business strategy; and
- data on the prior performance of the institution and similarly situated lenders.

The Federal bank regulators recently proposed changes to their CRA regulations that would, among other things, require that evidence of discriminatory, illegal, or abusive lending transactions be considered in an institution s CRA evaluation. Financial holding company subsidiaries must receive satisfactory or better CRA ratings to engage in financial holding company or subsidiary activities permitted by the GLB Act. Community Bank received a satisfactory CRA rating at its most recent examination on September 1, 2003.

Consumer Regulations

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

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

The GLB Act, which requires banks and their affiliated companies to adopt and disclose privacy policies, including policies regarding the sharing of personal information they obtain from customers with third parties; and

the rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

FDIC Insurance Assessments

Community Bank s deposits are primarily insured by the FDIC s Bank Insurance Fund, or BIF. The FDIC utilizes a risk-based deposit insurance premium schedule to determine the assessment rates for Bank Insurance Fund-insured depository institutions. Each financial institution is assigned to one of three capital groups:

well capitalized;

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adequately capitalized; or

undercapitalized.

Each financial institution is further assigned to one of three subgroups within a capital group, on the basis of supervisory evaluations by the institution s primary federal and, if applicable, state regulators and other information relevant to the institution s financial condition and the risk posed to the applicable insurance fund. The actual assessment rate applicable to a particular institution will, therefore, depend in part upon the risk assessment classification so assigned to the institution by the FDIC. The FDIC is presently considering whether to charge deposit insurance premiums based upon management weaknesses and whether the bank s underwriting practices, concentrations of risk, and growth are undisciplined or outside industry norms.

The BIF assessment rates currently range from zero basis points on deposits for a financial institution in the highest category, to 27 basis points on deposits for an institution in the lowest category. In addition, the Deposit Insurance Funds Act of 1996 authorizes the FDIC to collect The Financing Corporation, or FICO, deposit assessments on Bank Insurance Fund and Savings Association Insurance Fund-assessable deposits at the same rate. FICO assessments are set quarterly, and in 2003 ranged from 1.52 to 1.68 cents per $100 of assessable deposits. For the first and second quarters of 2004, the FICO assessment rate for such deposits will be 1.54 cents per $100 of assessable deposits. Community Bank paid insurance premiums in 2001, 2002 and 2003 of $91,509, $532,118 and $776,814, respectively, and paid FICO assessments of approximately $115,000, $99,000 and $73,000, in each of these years, respectively.

Enforcement Policies and Actions

The Federal Reserve, the FDIC and the Alabama Superintendent monitor compliance with laws and regulations. Violations of laws and regulations, or other unsafe and unsound practices, may result in these agencies imposing fines or penalties, issuing cease and desist orders or memorandums of understanding, or taking other enforcement actions. Under certain circumstances, these agencies may enforce these remedies directly against officers, directors, employees and others participating in the affairs of a bank or bank holding company. The regulatory agencies have extensive powers to enforce their agreements with banks and bank holding companies, including, among other actions, civil money penalties, and possible proceedings to terminate FDIC insurance. We presently are subject to a memorandum of understanding, a safety and soundness compliance plan and two cease and desist orders. See Our Current Regulatory Restrictions.

Fiscal and Monetary Policy

Banking is a business that depends on interest rate differentials. In general, the difference between the interest paid by a bank on its deposits and its other borrowings, and the interest received by a bank on its loans and securities holdings, constitutes the major portion of a bank s earnings. Thus, our earnings and growth will be subject to the influence of economic conditions generally, both domestic and foreign, and also to the monetary and fiscal policies of the United States and its agencies, particularly the Federal Reserve.

The Federal Reserve regulates the supply of money through various means, including open market dealings in United States government securities, the discount rate at which banks may borrow from the Federal Reserve, and the reserve requirements on deposits. The monetary policies of the Federal Reserve historically have had a significant effect on the operating results of commercial banks and will continue to do so in the future. The conditions in the national and international economies and money markets, as well as the actions and changes in policy by monetary and fiscal authorities, and their effect on us cannot be predicted.

Insurance Regulation

Community Insurance and Southern Select are licensed insurance agents and brokers for various insurance companies, and are subject to regulation by the Alabama Insurance Commission.

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Legislative and Regulatory Changes

On October 26, 2001, the International Money Laundering Abatement and Anti-Terrorism Funding Act of 2001, was enacted into law. This law restricts money laundering by terrorists in the United States and abroad. This Act specifies new know your customer requirements that will obligate financial institutions to take actions to verify the identity of the account holders in connection with opening an account at any U.S. financial institution. Banking regulators will consider compliance with the act s money laundering provisions in making decisions regarding approval of acquisitions and mergers. In addition, sanctions for violations of the act can be imposed in an amount equal to twice the sum involved in the violating transaction, up to $1.0 million.

Legislative and regulatory proposals regarding changes in banking laws, the regulation of banks, thrifts and other financial institutions, as well as bank and bank holding company powers are being considered by the executive branch of the Federal government, Congress and various state governments, including Alabama. The FDIC has proposed comprehensive deposit insurance reform legislation. Other proposals pending in Congress would, among other things, allow banks to pay interest on checking accounts and to establish interstate branches *de novo*. Certain of these proposals, if adopted, could significantly change the regulation of banks and the financial services industry. It cannot be predicted whether any of these proposals will be adopted, and, if adopted, how these proposals will affect us.

In the wake of the tragic events of September 11th, on October 26, 2001, the President signed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism, or USA PATRIOT, Act of 2001. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and know your customer standards in their dealings with foreign financial institutions and foreign customers. For example, the enhanced due diligence policies, procedures, and controls generally require financial institutions to take reasonable steps:

- to conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transaction;
- to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions;
- to ascertain for any foreign bank, the shares of which are not publicly traded, the identity of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner; and
- to ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

The USA PATRIOT Act requires financial institutions to establish anti-money laundering programs. The USA PATRIOT Act sets forth minimum standards for these programs, including:

- the development of internal policies, procedures, and controls;
- the designation of a compliance officer;

an ongoing employee training program; and

an independent audit function to test the programs.

In addition, the USA PATRIOT Act authorizes the Secretary of the Treasury to adopt rules increasing the cooperation and information sharing between financial institutions, regulators, and law enforcement authorities regarding individuals, entities and organizations engaged in, or reasonably suspected based on credible evidence of engaging in, terrorist acts or money laundering activities. Any financial institution complying with these rules will not be deemed to have violated the privacy provisions of the Gramm-Leach-Bliley Act, as discussed above.

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Our Current Regulatory Restrictions

We presently are subject to a number of restrictions that have been imposed by our regulators under four separate regulatory orders. We have summarized these regulatory orders below, and, although we presently are operating under these orders, we cannot assure you that we will be able to continue to operate under these orders or that our regulators will not impose additional orders and restrictions upon us in the future.

Memorandum of Understanding between Community Bancshares and the Federal Reserve Bank of Atlanta

On April 9, 2001, the board of directors of Community Bancshares entered into a Memorandum of Understanding, or MOU, with the Federal Reserve Bank of Atlanta, or the FRB, after the FRB rated our condition as less than satisfactory. Under the terms of the MOU:

- Community Bancshares is prohibited from conducting the following activities without the FRB s prior written approval:
  - declaring or paying any dividends or any other capital distributions on our capital stock, including repurchasing of corporate stock;
  - incurring additional indebtedness or altering the terms of existing indebtedness; or
  - increasing the annual management fees charged by Community Bancshares to Community Bank;
- Community Bancshares must maintain a Tier 1 leverage ratio of at least 6.5% as of the end of every fiscal quarter, and must notify the FRB in the event that the ratio is anticipated to fall below that level at the end of any calendar quarter;
- Community Bancshares must review at least quarterly and update and provide to the FRB its Capital and Income Plan, detailing the capital positions and earnings performance of Community Bank and describe how those positions and performance would be maintained at adequate levels;
- Within 60 days of the date of the MOU, Community Bancshares was required to:
  - establish a capital and dividend policy, including minimum target levels of capital and establishing appropriate guidelines for dividends; and
  - provide the FRB with a plan to strengthen its overall internal audit program;
- Within 30 days of the date of the MOU, Community Bancshares was required to provide the FRB with a contingency plan for conserving or raising cash, as well as a listing of loans or other credit extended by Community Bank to facilitate the purchase of Community Bancshares common stock;

For any loans determined not to be in compliance with Section 23A of the Federal Reserve Act, Community Bancshares agreed to provide a plan detailing how the violation(s) would be corrected;

Community Bancshares agreed to provide the FRB, within 30 days of the end of each quarter, a written report detailing the action taken to ensure compliance with the MOU, which must include:

updated cash flow statements showing the projected sources and uses of funds for a 3-year period, consisting of the current year and the next two years;

parent-only balance sheets, income statements and statement of changes in stockholders equity for the period ending that quarter;

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a litigation update concerning suits involving current or former stockholders; and

copies of any Bank correspondence with the Alabama Banking Department, which, together with the Alabama Superintendent of Banks, we refer to as the Department, and the FDIC regarding compliance with their supervisory actions.

In addition, on March 8, 2002, the FRB requested, and Community Bancshares agreed, to an amendment to the MOU, which prohibits Community Bancshares from making any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities without the FRB s prior written approval. On November 27, 2002, we agreed to a second amendment, which prohibits Community Bancshares, including any of its non-bank subsidiaries and the Employee Stock Ownership Plan, from amending any existing compensation arrangements or initiating any new compensation, indemnification or other payment arrangements with or on behalf of any employee, officer or director of Community Bancshares without the FRB s prior approval.

We believe that we are in compliance in all material respects with the MOU and its amendments, all of which are still in effect.

Safety and Soundness Compliance Plan between Community Bank and the FDIC

Based on an examination as of June 30, 2001, the FDIC and the Alabama State Banking Department requested Community Bank to develop and adopt a Safety and Soundness Compliance Plan. This Plan was adopted on March 5, 2002, and it replaced a similar document known as a Memorandum of Understanding that had been issued by the FDIC and the Alabama State Banking Department on April 18, 2001. Pursuant to the Plan:

the board of directors was required to review Community Bank s organizational structure and staffing requirements and then hire and train any additional personnel necessary to comply with the Plan;

the board of directors was required to review and revise Community Bank s loan policy and underwriting standards, loan collection plan, allowance for loan losses methodology, interest rate risk policy and asset liability management policy;

the board of directors was required to adopt an internal audit program, an internal controls program, procedures for internal and external loan documentation review and a plan to reduce classified assets;

Community Bank is restricted from extending credit to borrowers holding classified loans;

the board of directors committed to maintaining a Tier 1 capital ratio of at least 7.0% and to obtain regulatory approval prior to paying any dividends to Community Bancshares;

the board of directors is required to submit a budget and profit plan, and has to review the adequacy of loan loss allowances to assure an adequate balance prior to submitting Community Bank s Reports of Condition and Income;

Community Bank was required to engage an outside accounting firm to perform its internal audit function, and must form an administration department to strengthen its internal controls; and

management is required to make monthly progress reports to the board of directors regarding its success in meeting the Plan requirements and to submit quarterly progress reports to the regulators.

The Safety and Soundness Compliance Plan is still in effect, and we continue to make detailed quarterly progress reports to our regulators. We believe that we are in compliance in all material respects with the Plan.

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Cease and Desist Order between Community Bank and the Alabama State Banking Department

On December 10, 2002, the board of directors of Community Bank entered into an agreement with the Alabama State Banking Department. The agreement provided that the board of directors would take certain actions regarding:

- an investigation into payments made in connection with several construction projects of Community Bank;
- approval and management of payments and loans involving our directors, officers and employees; and
- expense controls and review of financial statements.

With respect to the investigation of construction payments, Community Bank s Audit Committee, with the assistance of independent accountants and counsel, must determine whether any directors, officers or employees improperly benefited from payments made by Community Bank for construction projects. If any of these persons received improper benefits, then the Audit Committee must determine the amount of such benefits, fix an appropriate rate of interest due to Community Bank on the principal amount of any benefit, require restitution of the amount of the benefit, plus accrued interest, and investigate any apparent negligence on the party of Community Bank employees with regard to improper payments. Community Bank has reported the Audit Committee s progress and findings to the Alabama State Banking Department for its review.

The board of directors of Community Bank has agreed, among other things, to require board approval of all extensions of credit to insiders, as defined in the Federal Reserve s Regulation O. The board also has agreed to implement certain procedures for managing existing loans to insiders, including limitations on renewals, methods of collection of adversely classified loans to certain insiders, obtaining current appraisals on collateral, and securing adversely classified loans. In addition, the board has agreed to:

- limit future extensions of credit and any payments other than ordinary compensation to any director, officers or employee who, after investigation, is deemed to owe restitution to Community Bank or whose loans have been adversely classified;
- consult with the Alabama State Banking Department regarding settlement of litigation; and
- obtain prior approval for sales or transfers of Community Bank s assets benefiting any director, officer or employee deemed to owe restitution.

In an effort to control Community Bank s expenses, the board has directed the Audit Committee to review for adequacy and appropriateness bills paid by Community Bank for professional services from 1998 to the present, to recover fees improperly paid, if any, for the benefit of third parties and to establish additional internal controls for the payment of future bills.

We believe that we are in compliance in all material respects with this cease and desist order.

Stipulation and Consent to the Issuance of an Order to Cease and Desist between Community Bank and the FDIC

On March 4, 2003, the board of directors of Community Bank and the FDIC entered into a Stipulation and Consent to the Issuance of an Order to Cease and Desist. The Order was effective on March 22, 2003. The FDIC alleged deficiencies relating to the supervision of the board of directors over active management of Community Bank, supervision and control of lending to insiders and accurate maintenance of Community Bank s books and records. The FDIC characterized these deficiencies as unsafe and unsound banking practices. The board of directors consented to the Order without admitting or denying those allegations. Pursuant to the Order, the board of directors agreed to cease and desist from conduct giving rise to the noted deficiencies and to:

develop, within 30 days of the effective date of the Order, a written plan specifying the responsibilities and lines of authority for Community Bank s executive officers and outlining internal controls to ensure compliance with the plan;

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refrain from making, renewing or modifying any loans to current or former executive officers or directors without prior approval of the FDIC and the Alabama State Banking Department;

amend Community Bank s books and records to reflect the actual value of bank premises and fixed assets; and

supply a copy of the Order to Community Bancshares and provide Community Bancshares with a summary of the Order for inclusion in Community Bancshares next stockholder communication.

We believe that we are in compliance in all material respects with all provisions of the Order and the only on-going requirement relates to loans to former executive officers and directors.

Statistical Disclosure

Statistical and other information regarding the following items are set forth in Management s Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 2. PROPERTIES.

Our corporate headquarters is owned by Community Bank and located at 68149 Main Street (U.S. Highway 231) in Blountsville, Alabama. Community Bank s administrative, operational, accounting and legal functions are housed in three buildings constructed in 1997, all of which are located on the same property as the corporate headquarters. These buildings, which collectively offer a total of approximately 72,500 square feet of office space on seven acres of land, are in good condition.

The main banking office of Community Bank is located at 69156 Main Street, Blountsville, Alabama. The premises are owned by Community Bank. This building offers a total of 7,500 square feet of office space and is in good condition.

At December 31, 2003, Community Bank owned or leased buildings that were used in the normal course of business in nine counties in Alabama, including Blount, Lauderdale, Limestone, Madison, Marengo, Marion, Morgan, Perry and Winston Counties. 1st Community Credit owned or leased buildings that were used in the normal course of business in ten counties in Alabama, including Blount, Cullman, Marshall, Morgan, Limestone, Lawrence, Etowah, Madison, DeKalb and Walker Counties. Community Insurance Corp. and its subsidiary, Southern Select Insurance, Inc., owned a building that is used in the normal course of business in Madison County, Alabama. The Company presently believes that none of these other facilities are, individually, material to its operations, and, if the Company was forced for any reason to vacate or sell any of these other facilities, the Company presently believes that it would be able to timely identify and occupy suitable alternative locations on equally favorable terms.

For information about the amounts at which bank premises, equipment and other real estate are recorded in our financial statements and information relating to commitments under leases, see our consolidated financial statements and the accompanying notes to consolidated financial statements included elsewhere in this report.

ITEM 3. LEGAL PROCEEDINGS.

Background

At a June 20, 2000 meeting of the board of directors of Community Bank, one of Community Bank s directors brought to the attention of the board of directors the total amount of money that Community Bank had paid to subcontractors in connection with the construction of a new Community Bank branch office in Guntersville, Alabama. Based upon the size of this amount, management commenced an investigation into these expenditures.

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At the request of management, the architects and subcontractors involved in the construction project made presentations to the boards of directors of the Community Bancshares and Community Bank on July 15 and July 18, 2000, respectively. At the July 18, 2000 meeting of the board of directors of Community Bank, another director alleged that Community Bank had been overcharged by subcontractors on that construction project, as well as on another construction project that remained uncompleted at that time.

On July 18, 2000, the boards of directors of Community Bancshares and Community Bank appointed a joint committee comprised of independent directors to investigate these alleged overcharges. The joint committee retained independent legal counsel and an independent accounting firm to assist its investigation and has since made its report to the boards of directors.

Community Bank s directors who alleged the construction overcharges also informed bank regulatory agencies and law enforcement authorities of their concerns. These agencies and authorities conducted their own investigations into this matter. Based on its findings, the FDIC issued restitution and/or removal orders against Kennon R. Patterson, Sr., former Chairman and Chief Executive Officer of the Company and Community Bank, and Larry Bishop, former Vice President of Community Bank. These regulatory actions are still pending at this time. The board of directors of Community Bancshares and the board of directors of Community Bank terminated Kennon R. Patterson, Sr. on January 27, 2003, and the board of directors of Community Bank terminated Larry Bishop on February 6, 2003. On October 29, 2003, the United States Department of Justice announced the filing of a 25-count indictment against Messrs. Patterson and Bishop, and a construction contractor, in connection with a scheme to divest Community Bank s funds for Mr. Patterson s personal benefit. On November 14, 2003, Mr. Patterson informed Community Bancshares that he was taking a leave of absence from Community Bancshares board of directors pending a resolution of the criminal charges against him. Mr. Patterson stated that he would not seek re-election to Community Bancshares board of directors if the criminal charges were not resolved prior to the expiration of his current term in 2005. Community Bancshares and Community Bank continue to seek Mr. Patterson s resignation as a director of Community Bancshares and recover all amounts owed by Mr. Patterson to Community Bank.

Patterson Litigation

Plaintiffs:	Kennon R. Patterson, Sr., Community Bancshares s former Chairman, President and Chief Executive Officer
Defendants:	Community Bancshares, Community Bank, five of the directors of Community Bancshares and Community Bank, and Powell, Goldstein, Frazer and Murphy, LLP, as counsel to Community Bank s Audit Committee

On April 9, 2003, Mr. Patterson filed an adversary proceeding against the defendants in the United States Bankruptcy Court for the Northern District of Alabama in connection with his petition for protection under Chapter 11 of the United States Bankruptcy Code. Mr. Patterson s complaint:

alleges that Community Bancshares breached its employment agreement with Mr. Patterson by terminating his employment on January 27, 2003 and failing to pay him for compensation and benefits that had accrued prior to his termination; and

alleges that Community Bank, members of Community Bank s Audit Committee, the Audit Committee s independent counsel and Community Bancshares current Chairman, President and Chief Executive Officer conspired to interfere with Mr. Patterson s contract and business relationship with Community Bancshares.

The suit seeks damages in excess of $150.0 million for, among other things, lost compensation and benefits, mental anguish, and damage to Mr. Patterson s reputation. Community Bancshares presently believes that this lawsuit is without merit and intends to vigorously defend itself against this action.

On May 9, 2003 the defendants filed a motion to dismiss the suit, and, on June 17, 2003, the court denied the motion to dismiss the suit as to Community Bancshares, Community Bank and the named directors. On July 7, 2003, those defendants filed a counterclaim against Mr. Patterson asserting that Mr. Patterson breached his employment agreement with Community Bancshares, engaged in fraudulent conduct, and converted property belonging to Community Bank to his personal use.

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On January 12, 2004, the bankruptcy proceeding filed by Mr. Patterson was dismissed without prejudice. Community Bancshares, Community Bank and the individual defendants moved to dismiss the adversary proceeding in bankruptcy filed against them by Mr. Patterson. That motion is currently under consideration by the Bankruptcy Court for the Northern District of Alabama.

Further, on March 15, 2004 the Employee Stock Ownership Plan, or ESOP, of Community Bancshares, together with the ESOP trustee, North Star Trust Company, filed suit in the United States District Court for the Northern District of Alabama against Mr. Patterson. In the lawsuit, the ESOP seeks damages for alleged breaches of fiduciary duty by Mr. Patterson, and both the ESOP and the trustee seek a declaratory judgment that the ESOP has a right of set-off against Mr. Patterson s account in the ESOP, and the ESOP is not required to make a distribution of funds to Mr. Patterson.

Corr Family Litigation

Plaintiffs:	Bryan A. Corr and six other of Community Bancshares stockholders related to Mr. Corr
Defendants:	Community Bancshares, Community Bank, and certain named directors and officers of Community Bancshares and Community Bank

On September 14, 2000, the plaintiffs filed an action against the defendants in the Circuit Court of Blount County, Alabama, alleging that the named directors actively participated in or ratified the misappropriation of corporate income by Mr. Patterson and others. Because the action was not styled as a stockholder derivative action, on January 3, 2001, the defendants filed a motion for summary judgment on the basis that these claims are derivative in nature and cannot be brought on behalf of individual stockholders. On May 15, 2003, the court granted the defendants motion for summary judgment, and the plaintiffs have appealed the court s ruling.

Benson Litigation

Plaintiffs:	M. Lewis Benson, Doris E. Benson, John M. Packard, Jr. and Andy C. Mann, four of Community Bancshares stockholders
Defendants:	Community Bancshares, Community Bank, certain of the present and former directors of Community Bancshares and Community Bank, an employee of Community Bank and two construction subcontractors previously hired by the Company

On July 21, 2000, the plaintiffs filed a lawsuit, styled as a stockholder derivative suit, in the state Circuit Court of Marshall County, Alabama against the defendants, relating to alleged overcharges in construction costs. At the time, these charges were being investigated by a joint committee of the boards of directors of Community Bancshares and Community Bank.

The complaint:

alleges that the directors, officers and employee named as defendants (i) breached their fiduciary duties, (ii) failed to properly supervise officers and agents of Community Bancshares and Community Bank, and (iii) permitted waste of corporate assets by permitting the subcontractor defendants to overcharge Community Bank in connection with the construction of two new Community Bank branch offices, and to perform the construction work without written contracts, budgets, performance guarantees and assurances of indemnification;

alleges that Kennon R. Patterson, Sr., the Company s former Chairman, President and Chief Executive Officer, breached his fiduciary duties by permitting the two named subcontractors to overcharge for work performed on the two construction projects in exchange for discounted charges for work these subcontractors performed in connection with the construction of Mr. Patterson s residence;

- alleges that the director defendants knew or should have known of this alleged arrangement between Mr. Patterson and the subcontractors; and

- alleges that Mr. Patterson, the Community Bank employee and the two subcontractor defendants made false representations and suppressed information about the overcharges and arrangement between Mr. Patterson and the subcontractors.

On August 15, 2000, the plaintiffs filed an amended complaint that generally reiterates the allegations of the original complaint, and further:

- alleges that the Bank was overcharged on all construction projects from January 1997 to the present; and

- alleges that the defendants breached their fiduciary duties and are guilty of gross financial mismanagement, including making or approving loans and taking improper actions to conceal the fact that the loans were uncollectible.

On September 18, 2000, the plaintiffs filed a second amended complaint generally reiterating the allegations of the original and first amended complaints, and further:

- alleging that the plaintiffs were improperly denied their rights to inspect and copy certain records of Community Bancshares and Community Bank; and

- alleging that the directors of Community Bancshares abdicated their roles as directors either by express agreement or as a result of wantonness and gross negligence.

The second amended complaint further asserts that the counts involving inspection of corporate records and director abdication are individual, non-derivative claims. The second amended complaint seeks, on behalf of Community Bancshares, an unspecified amount of compensatory damages in excess of $1.0 million, punitive damages, disgorgement of improperly paid profits and appropriate equitable relief. Upon a motion of the defendants, the case was transferred to the state Circuit Court in Blount County, Alabama by order dated September 21, 2000, as amended on October 12, 2000.

Tentative settlements of the lawsuit were announced in November 2002, August 2003 and November 2003 but were not finalized.

On January 6, 2004, the Circuit Court of Blount County, Alabama disapproved a proposed settlement of the Benson and Packard derivative lawsuits. Subsequently, another settlement proposal was made by the individual defendants, other than Kennon R. Patterson, Sr., directly to Community Bancshares and Community Bank. Pursuant to this new settlement, Community Bank would receive $1.655 million, less any fees awarded by the Court to the plaintiffs attorneys. A special committee of the Boards of Directors of the two companies, consisting of the members who are not defendants in the cases, accepted the offer which was then was filed with the Court on February 19, 2004. No hearing on the motion has yet been set. All proceedings in these cases have been stayed pending a decision from the Supreme Court of Alabama as to whether the cases can proceed as to Mr. Patterson and Larry Bishop prior to their trial on criminal charges.

On or about April 5, 2004, Travelers Casualty and Surety Company of America filed a motion for permission to intervene in the Benson litigation asserting that, to the extent that it is required to reimburse Community Bancshares and Community Bank for losses pursuant to the Company s fidelity bond, it will be subrogated to the derivative claims made on behalf of Community Bancshares and Community Bank in the Benson litigation.

Packard Derivative Litigation

Plaintiffs:	M. Lewis Benson, Doris E. Benson, John M. Packard, Jr. and Andy C. Mann, four of Community Bancshares stockholders
Defendants:	Sheffield Electrical Contractors, Inc., Steve Sheffield, Jay Bolden, Dudley, Hopton-Jones, Sims & Freeman, PLLP, Glynn C. Debter, Kennon R. Patterson, Jr., Robert O. Summerford, Jimmie A. Trotter, John L. Lewis, Jr., Merritt M. Robbins, Stacey W. Mann, B. K. Walker, Jr., Denny Kelly, Roy B. Jackson, Loy D. McGruder, and Hodge Patterson

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On April 4, 2003, the plaintiffs, which are the same as in the Benson case described above, filed a derivative action against the defendants. This action, while stemming from the same facts alleged in the Benson Litigation, is based not upon what the director-defendants did (and did not do) before learning of the over billing [sic.] allegations against [Mr.] Patterson in July 2000 but, instead, is based upon what they have done (and failed to do) after the filing of the Benson lawsuit that is, after they learned of the allegations against [Mr.] Patterson in July 2000.

On June 18, 2003, the Circuit Court of Jefferson County, Alabama granted the motion filed by Community Bancshares, Community Bank and most of the individual defendants to transfer the suit to the Circuit Court of Blount County, Alabama.

On or about October 1, 2003, one of the defendants, Dudley, Hopton-Jones, Sims & Freeman, PLLP, formerly the certified public accountants and outside auditors for Community Bancshares and Community Bank, filed a cross-claim against Community Bank, Community Bancshares, Glynn C. Debter, Kennon R. Patterson, Jr., Robert O. Summerford, Jimmie A. Trotter, John L. Lewis, Jr., Merritt M. Robbins, Stacey W. Mann, B. K. Walker, Jr., Denny Kelly, Roy B. Jackson, Loy D. McGruder, and Hodge Patterson, all of whom are directors or former directors of Community Bancshares and/or Community Bank. The cross-claim demands compensatory damages, interest, and costs, including the amount of any adverse judgment entered in this cause against Dudley, Hopton-Jones. Punitive damages are also demanded in some counts. The basis for the claims is common law indemnity, contractual indemnity, negligence, misrepresentation, suppression, and concealment of material facts, and, civil conspiracy.

On November 11, 2003 Community Bancshares, Community Bank, and certain individual defendants entered into an agreement to settle this case, which was not finalized.

On January 6, 2004, the Circuit Court of Blount County, Alabama disapproved a proposed settlement of the Benson and Packard derivative lawsuits. Subsequently, another settlement proposal was made by the individual defendants, other than Kennon R. Patterson, Sr., directly to Community Bancshares and Community Bank. Pursuant to this new settlement, Community Bank would receive $1.655 million, less any fees awarded by the Court to the plaintiffs attorneys. A special committee of the Boards of Directors of the two companies, consisting of the members who are not defendants in the cases, accepted the offer which was then was filed with the Court on February 19, 2004. No hearing on the motion has yet been set. All proceedings in these cases have been stayed pending a decision from the Supreme Court of Alabama as to whether the cases can proceed as to Mr. Patterson and Larry Bishop prior to their trial on criminal charges.

Lending Acts Litigation

Plaintiffs:	William Alston, Murphy Howard, and Jason Tittle
Defendants:	Community Bancshares, Community Bank, Holsombeck Motors, Inc., Lee Brown d/b/a Alabama Bond & Investigation a/k/a ABI Recovery, Chris Holmes d/b/a Alabama Bond & Investigation a/k/a ABI Recovery, Regina Holsombeck, Kennon Ken Patterson, Sr., Hodge Patterson, James Timothy Tim Hodge, Ernie Stephens, and the State of Alabama Department of Revenue

On October 11, 2002, the plaintiffs filed a class action against the defendants alleging that Community Bank and others conspired or used extortionate methods to effect a lending scheme of churning phantom loans, and that profits from the scheme were used to secure an interest in and/or to invest in an enterprise that affects interstate commerce. The plaintiffs specifically allege that Community Bank used various methods to get uneducated customers with fair to poor credit to sign numerous phantom loans when the customers only intended to sign for one loan. Claims include racketeering activity within the meaning of the Racketeer Influenced and Corrupt Organizations Act of 1970, conspiracy, spoliation, conversion, negligence, wantonness, outrage, and civil conspiracy.

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On or about February 17, 2004, an amended complaint was filed in this lending acts litigation. The amended complaint, which completely replaces the original complaint, omits class action and racketeering claims and alleges violations of the Truth in Lending Act and Regulation Z of the Federal Reserve Board in addition to conversion, negligence, outrage, suppression, fraud and misrepresentation, trespass, conspiracy and failure to provide notice before disposition of collateral for loans. On April 2, 2004, eighty-one individuals, most of whom were formerly members of the purported class in the lending acts litigation filed by William Alston, filed suit against Community Bancshares, Community Bank and a former Community Bank employee in the Circuit Court of Jefferson County, Alabama. This suit claims that the defendants injured the plaintiffs, primarily in connection with lending at Community Bank s office in Double Springs, Alabama, by wrongfully taking property, committing fraud, furnishing inaccurate information to credit reporting agencies, negligently hiring, training and supervising employees, negligently handling customer accounts, altering loan documents and failing to honor oral and written contracts with the plaintiffs.

Employee Litigation

Plaintiffs:	Bishop K. Walker, Jr., former Senior Executive Vice President and General Counsel of Community Bancshares, and Denny G. Kelly, former President of Community Bank
Defendants:	Community Bancshares, Community Bank, Kennon R. Patterson, Sr., and a number of unidentified defendants

On May 5, 2003, the plaintiffs filed separate suits in the Circuit Court of Blount County, Alabama, against the defendants alleging that they were induced to retire based upon misrepresentations made by Kennon R. Patterson, Sr., who at the time was Community Bancshares Chairman, President and Chief Executive Officer. The plaintiffs claim that Mr. Patterson s actions constituted fraud, promissory fraud, fraudulent suppression, fraud in the inducement, deceit, fraudulent deceit, negligence, recklessness, wantonness and breach of contract. The complaints seek an unspecified amount of compensatory and punitive damages.

On October 23, 2003 Community Bancshares and Community Bank filed counter claims against Mr. Walker and Mr. Kelly seeking repayment of amounts paid to them as part of a severance arrangement and, in the case of Mr. Kelly, amount owed to Community Bank in connection with the two loans from Community Bank to Mr. Kelly.

Other Litigation

In addition to the foregoing, Community Bancshares and its affiliates also are from time to time parties to other legal proceedings arising in the ordinary course of Community Bancshares business. Community Bancshares presently believes that, other than the litigation discussed above, there is no other litigation to which Community Bancshares or its affiliates presently are subject that, if such litigation were to result in an outcome unfavorable to Community Bancshares, would, individually or in the aggregate, have a material adverse effect on Community Bancshares financial condition or results of operations.

Community Bancshares Certificate of Incorporation and Bylaws provide that, in certain circumstances, Community Bancshares will indemnify its directors and officers, and, provided such persons acted in accordance with the standards set forth in the Delaware General Corporation Law and Community Bancshares organizational documents, advance expenses to its directors and officers in connection with investigations and proceedings in connection with their service as officers and directors of Community Bancshares.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matter was submitted to a vote of security holders by solicitation of proxies or otherwise during the fourth quarter of 2003.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Number of Shares and Holders

We presently have no shares of our preferred stock outstanding. At March 18, 2004, we had approximately 8,376,163 shares of our common stock outstanding and held by approximately 2,320 stockholders of record.

Market Information

There is no active trading market for our common stock, and we presently do not expect any active trading market for our common stock to develop. Our common stock has been purchased and sold infrequently in private transactions, and there is no reliable information available as to trades of our common stock, or as to the prices at which our common stock has traded. Our management has reviewed the limited information available to us as to the ranges at which shares of our common stock has been traded. The following data regarding our common stock is provided for informational purposes only, and should not be viewed as indicative of the actual or market value of our common stock.

	Estimated Price Range Per Share	
	High	Low
2003:		
Fourth Quarter	$ 5.50	$ 5.00
Third Quarter	8.00	4.50
Second Quarter	7.00	4.50
First Quarter	15.00	10.00
2002:		
Fourth Quarter	$ 15.00	$ 15.00
Third Quarter	15.00	15.00
Second Quarter	20.00	15.00
First Quarter	15.00	15.00
2001:		
Fourth Quarter	$ 18.00	$ 12.00
Third Quarter	15.00	15.00
Second Quarter	22.00	15.00
First Quarter	22.00	15.00

In addition, we engaged Alex Sheshunoff & Co. Investment Banking, LP, to perform independent valuations of the fair market value of our common stock held by our Employee Stock Ownership Program, or ESOP, as of December 31, 2002 and 2001, and, at each of those dates, Alex Sheshunoff determined the value of the shares of our common stock held by the ESOP to be $7.00 per share. In addition, we have engaged Alex Sheshunoff to perform an independent valuation of the fair market value of our common stock held by our ESOP as of December 31, 2003. As of the date of this Report, however, we had not yet received the results of that valuation.

Recent Sales of Unregistered Securities

During the fourth quarter of 2003, the Company commenced a private placement of its common stock, and, as of December 31, 2003, the Company had sold 2,151,552 shares of its common stock at a price of $5.35 per share, resulting in net proceeds of approximately $10.4 million. In addition, the Company granted to those investors who initially purchased shares in the offering prior to December 31, 2003, as well as to one investor who purchased an additional 40,345 shares after December 31, 2003, an option to exchange by December 31, 2008, in whole but not in part, the shares of the Company s common stock purchased in the offering for shares of the Company s newly designated Series 2003 noncumulative preferred stock. The Company completed this offering on February 20, 2004, selling an additional 1,586,771 shares of its common stock for $7.9 million of additional net proceeds, resulting in the sale of a total of 3,738,323 shares for total net proceeds from the offering of $18.3 million.

The Series 2003 noncumulative preferred stock has a liquidation preference equal to the aggregate purchase price of the 2,191,897 shares of common stock initially purchased in the offering, and each whole share of the Series 2003 noncumulative preferred stock will have a liquidation preference of $500,000. The Series 2003 noncumulative preferred stock has, among other things, the following designations:

- The Series 2003 noncumulative preferred stock has terms consistent with the Company s Tier 1 capital treatment for regulatory purposes;

- The Series 2003 noncumulative preferred stock is noncumulative and is not entitled to the payment of, or otherwise accrue, any dividends;
- The Series 2003 noncumulative preferred stock is not entitled to the benefit of any sinking fund or similar arrangement;
- The Series 2003 noncumulative preferred stock has no preemptive, preferential or other right to purchase, subscribe for or convert into any other of the Company s securities;
- The Company is not required to purchase the shares of Series 2003 noncumulative preferred stock;
- Holders of the Series 2003 noncumulative preferred stock do not have registration rights requiring the Company to register the shares of the Series 2003 noncumulative preferred stock; and
- The Series 2003 noncumulative preferred stock has no voting power with respect to any Company matters, except in the case of a merger or a significant acquisition or sales transaction, in which case, the Series 2003 noncumulative preferred stock will be entitled to one vote per whole share, and will vote together, as one class, with the holders of our common stock.

The complete terms of the Series 2003 noncumulative preferred stock are set forth in the Certificate of Designation of the Series 2003 Noncumulative Preferred Stock of Community Bancshares, Inc., which the Company has filed with the Secretary of State of the State of Delaware as part of its Certificate of Incorporation.

No underwriters were involved in this offering. FIG Partners, L.L.C., an affiliate of Burke Capital Group, L.L.C., served as the Company s sole placement agent in the offering. The investors in the offering were comprised entirely of accredited investors, as that term is defined in Rule 501 of Regulation D promulgated under the Securities Act of 1933. The common stock and options issued by the Company in the offering were not registered under the Securities Act of 1933, in reliance upon the exemption from registration under Section 4(2) and the safe harbor afforded by Rule 506 of Regulation D. The certificates evidencing the shares of common stock and the options sold in the offering bear restrictive legends permitting the transfer of the underlying securities only upon registration of the securities or an exemption under the Securities Act, together with an opinion of counsel.

In connection with the offering, the Company entered into an engagement letter with FIG Partners, pursuant to which FIG Partners agreed to serve as placement agent for the offering, and the Company agreed to grant to FIG Partners, upon the closing of the offering, a warrant to purchase shares of the Company s common stock. In connection with the closing of the offering on February 20, 2004, the Company became obligated to issue to FIG Partners a warrant to purchase up to 140,187 shares of the Company s common stock at an exercise price of $5.89 per share. The warrant expires on February 20, 2008, and, until that date, may be exercised either in cash or pursuant to a cashless exercise.

Dividends

We have not declared or paid any dividends on our common stock since December 31, 2000. Generally, the payment of dividends on our common stock is subject to the prior payment of principal and interest on our long-term debt, the retention of sufficient earnings and capital in our operating subsidiaries and regulatory restrictions. Currently, Community Bank is subject to restrictions on its activities imposed by bank regulators, which, among

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other things, limit Community Bank s ability to pay dividends to Community Bancshares. Dividends from Community Bank historically have been the primary source of cash and income to Community Bancshares and, consequently, any restrictions on Community Bank s ability to pay dividends severely limits our liquidity and ability to pay dividends on our common stock.

Community Bancshares is similarly subject to a memorandum of understanding with the Federal Reserve that, among other things, prohibits us from declaring or paying any dividends on our common stock without the prior written approval of the Federal Reserve. In addition, because we have deferred our interest payments due upon our outstanding 10.875% junior subordinated debentures that support our trust preferred securities, we may not, under the terms of the indenture that governs those debentures, make any dividend payments on our common stock.

As a result, we presently do not anticipate declaring or paying dividends on our common stock during 2004 or at any time in the foreseeable future.

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ITEM 6. SELECTED FINANCIAL DATA.

The following table sets forth selected financial data for the last five years, and should be read in conjunction with the section in this Report entitled Management s Discussion and Analysis of Financial Condition and Results of Operations, as well as our consolidated financial statements and related notes contained elsewhere herein. All averages are daily averages.

	Years ended December 31,				
	2003	**2002**	**2001**	**2000**	**1999**
	(Dollars in thousands except per share data)				
Net interest income	**$ 18,860**	$ 23,505	$ 22,853	$ 22,418	$ 26,672
Provision for loan losses	**11,381**	10,033	6,096	7,573	4,459
Loss from continuing operations	**(13,100)**	(5,023)	(2,381)	(2,853)	**
Income (loss) from discontinued operations.		5,927	958	(167)	**
Net income (loss)	**(13,100)**	904	(1,423)	(3,019)	1,658
Per share data:					
Earnings (loss) per share from continuing operations basic	**(2.79)**	(1.08)	(0.52)	(0.64)	**
Earnings (loss) per share from continuing operations - diluted	**(2.79)**	(1.08)	(0.52)	(0.61)	**
Earnings per share basic	**(2.79)**	0.19	(0.31)	(0.68)	0.37
Earnings per share diluted	**(2.79)**	0.19	(0.31)	(0.65)	0.36
Cash dividends				0.75	0.60
Balance Sheet:					
Loans	**316,207**	359,184	501,519	528,316	498,726
Total assets	**558,555**	**567,596**	**727,591**	**713,518**	**674,898**
Deposits	**453,946**	459,464	617,706	600,901	573,261
FHLB long-term debt	**38,000**	38,000	38,000	38,000	40,000
Other long-term debt	**3,169**	3,578	4,667	5,675	6,637
Trust preferred securities	**10,000**	10,000	10,000	10,000	
Average equity	**36,984**	42,848	42,938	41,776	44,203
Average assets	**556,591**	629,481	725,461	710,915	632,713
Ratios:					
Return on average assets	**(2.35)%**	0.14%	(0.20)%	(0.42)%	0.26%
Return on average equity	**(35.42)**	2.11	(3.31)	(7.23)	3.75
Average equity to average assets	**6.64**	6.81	5.92	5.88	6.99

** 1999 data does not reflect separate net income components for discontinued operations of certain branches divested in 2002.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The purpose of this discussion is to assist in the understanding of, and to focus on the significant changes in, the financial condition and results of operations of the Company and its subsidiaries during each of 2001, 2002 and 2003. This discussion and analysis is intended to supplement and highlight information contained in, and should be read in conjunction with, the Company s consolidated financial statements and related notes and the selected financial data presented elsewhere in this report.

Overview

We conduct our operations, which consist primarily of traditional commercial banking operations, through Community Bank and its subsidiaries. Through Community Bank, we provide a full range of banking services to individual and corporate customers in nine counties in north Alabama Blount, Cullman, DeKalb, Etowah, Lauderdale, Limestone, Madison, Marshall and Morgan Counties; two counties in northwest Alabama Marion and Winston Counties; and two counties in southwest Alabama Marengo and Perry Counties. The retail nature of Community Bank s commercial banking operations allows for diversification of depositors and borrowers, and Community Bank s management believes it is not dependent upon a single or a few customers. Community Bank does not have a significant portion of commercial banking loans concentrated within a single industry or group of related industries. Also, we do not consider our commercial banking operations to be seasonal in nature.

For the year ended December 31, 2003, the Company had a loss of approximately $13.1 million. In comparison, the Company reported net income of approximately $904,000 for the year ended December 31, 2002. This approximately $14.0 million change is attributable to a variety factors, including, among other things:

- income of approximately $8.5 million from discontinued operations which was recorded in the Company s 2002 net income, and no similar income realized in 2003;

- an increase of approximately $7.1 million in noninterest expenses due to: (i) increased professional fees associated with continued litigation and regulatory issues the Company has been confronting; (ii) increased foreclosed assets and related costs, as the Company has identified and addressed problems in its loan portfolio and the resulting increase in foreclosed assets, (iii) impairments on fixed assets as part of the Company s branch rationalization decisions, and (iv) losses that were realized on certain pending litigation matters;

- a decline of approximately $4.6 million in net interest income occurred in 2003, primarily due to: (i) lower levels of earning assets, resulting from the Company s decreased new loan growth and an increase in contractual and early payments, as well as charge-offs and foreclosures, and (ii) lower yields on earning assets due to: (x) an overall lower interest rate environment, (y) increased nonaccrual loans, and (z) increased levels of investment securities, which typically have lower yields than loans; and

- an increase of approximately $1.4 million in the provision for loan losses, reflecting the Company s continuing efforts to timely identify and resolve problem loans.

These factors were partially offset by a related tax benefit during 2003 of approximately $8.1 million.

During the fourth quarter of 2003, the Company commenced a private placement of its common stock, and, as of December 31, 2003, the Company had sold 2,151,552 shares of its common stock at a price of $5.35 per share, resulting in net proceeds of approximately $10.4 million. In addition, the Company granted to those investors who initially purchased shares in the offering prior to December 31, 2003, as well as to one investor who purchased an additional 40,345 shares after December 31, 2003, an option to exchange by December 31, 2008, in whole but not in part, the shares of the Company s common stock purchased in the offering for shares of the Company s newly designated Series 2003 noncumulative preferred stock. The Series 2003 noncumulative preferred stock has a liquidation preference equal to the aggregate purchase price of the 2,191,897 shares of common stock initially purchased in the offering, and each whole share of the Series 2003 noncumulative preferred stock will have a

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liquidation preference of $500,000. The Company completed this offering on February 20, 2004, selling an additional 1,586,771 shares of its common stock for $7.9 million of additional net proceeds, resulting in the sale of a total of 3,738,323 shares for total net proceeds from the offering of $18.3 million.

In connection with the offering, the Company entered into an engagement letter with FIG Partners, L.L.C., an affiliate of Burke Capital Group, L.L.C., pursuant to which FIG Partners agreed to serve as placement agent for the offering, and the Company agreed to grant to FIG Partners, upon the closing of the offering, a warrant to purchase shares of the Company s common stock. In connection with the closing of the offering on February 20, 2004, the Company became obligated to issue to FIG Partners a warrant to purchase up to 140,187 shares of the Company s common stock at an exercise price of $5.89 per share. The warrant expires on February 20, 2008, and, until that date, may be exercised either in cash or pursuant to a cashless exercise.

Primary Sources of Revenues and Expenses

Net Interest Income

While Community Bank provides most traditional banking services, its principal activities as a community bank are the taking of demand and time deposits and the making of secured and unsecured consumer loans and commercial loans in its markets. As a result, our principal source of revenue is net interest income at Community Bank. Net interest income is the difference between:

- income we receive on our interest-earning assets, such as investment securities and loans; and
- payments we make on our interest-bearing sources of funds, such as deposits and borrowings.

The level of net interest income is determined primarily by the average balances, or volume, of interest-earning assets and the various rate spreads between the interest-earning assets and our funding sources. Changes in our net interest income from period to period result from, among other things:

- increases or decreases in the volumes of interest-earning assets and interest-bearing liabilities;
- increases or decreases in the average rates earned and paid on those assets and liabilities;
- our ability to manage the interest-earning asset portfolio, which includes loans;
- the availability and costs of particular sources of funds, such as non-interest bearing deposits; and

- our ability to "match" our liabilities to fund our assets.

Net Noninterest Income

Our net noninterest revenues consist primarily of:

- service charges on customer deposit accounts;
- insurance commissions;
- securities gains or losses; and
- other service fees charged to customers.

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Our net noninterest expenses consist primarily of:

- salaries and employee benefits;
- costs to hold and maintain premises and equipment;
- insurance;
- director and committee fees;
- professional service fees, especially legal and accounting; and
- litigation losses.

Critical Accounting Policies

The Company s accounting policies are established in accordance with accounting principles generally accepted in the United States and general practices within the Company s industry. The application of certain of these accounting policies involves a significant amount of judgment as well as the use of estimates and assumptions based upon information that the Company has at the time. These estimates and judgments involve significant uncertainties, and are susceptible to change. If different assumptions or conditions were to prevail, depending upon the magnitude of any discrepancies from the Company s estimates and judgments, then the Company s financial condition and results of operations may prove to be materially different from the presentation herein.

The Company recognizes the following as critical accounting policies:

Accounting for Allowance for Loan Losses. Management analyzes the loan portfolio to determine the adequacy of the allowance for loan losses and the appropriate provision required to maintain a level that management considers to be adequate to absorb anticipated loan losses. When management believes that the collection of the principal of a loan is unlikely, that loan is charged off against the allowance for loan losses. Subsequent recoveries of principal on that loan are added back to the allowance for loan losses. Management s evaluation of the adequacy of the allowance for loan losses is based on a formal analysis which assesses the risks within the loan portfolio. Among other factors that management considers are the following:

- the Company s past loan loss experience;
- known and inherent risks in the loan portfolio, including past due and nonperforming loans;
- adverse situations that may affect the borrowers ability to repay those loans;

the estimated value of any underlying collateral;

the reviews of regulators; and

an analysis of current economic conditions.

The consideration and application of many of these factors involve assumptions, estimates and judgments that are inherently uncertain and are subject to change. Management believes that the allowance for loan losses was adequate at December 31, 2003. While management uses available information to recognize losses on loans, future additions to the allowance for loan losses may be necessary based on economic changes and changes to various borrowers. Certain economic and interest rate factors could have a material effect on the determination of the allowance for loan losses. Our allowance for loan losses is also subject to regulatory examinations and determinations as to adequacy, which may take into account such factors as the methodology used to calculate the allowance for loan losses and the size of the allowance for loan losses in comparison to a group of peer banks identified by our regulators. During their routine examinations of banks, the Federal Deposit Insurance Corporation and the Alabama State Banking Department may require a bank to make additional provisions to its allowance for loan losses where, in the opinion of the regulators, credit evaluations and allowance for loan loss methodology differ materially from those of management.

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Accounting for Income Taxes. The Company uses the asset and liability method of accounting for income taxes. The Company s determination of the deferred and current provision for income taxes requires analysis by the Company s management of certain transactions and the related tax laws and regulations applicable to those transactions. Management exercises significant judgment in evaluating the amount and timing of the recognition of the resulting tax liabilities and assets. Those judgments and estimates are re-evaluated on a continual basis as regulatory and business factors change. However, because management s judgments and estimates are inherently subjective and subject to change, there can be no assurance that the Company s determination of the provision for income taxes will not be changed, upward or downward, in future periods.

Accounting for Contingencies. Statement of Financial Accounting Standard No. 5 (SFAS 5), Accounting for Contingencies, defines a contingency as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss. It will ultimately be resolved when one or more future events occur or fail to occur. SFAS 5 defines the different levels of probability as to whether or not future events will confirm the existence of a loss as follows:

probable meaning that the future event or events are likely to occur;

reasonably possible meaning that the chance of the future event or events occurring is more than remote but less than likely; or

remote meaning that the chance of the future event or events is slight.

Professional judgment is required to classify the likelihood of the future events occurring. In assessing these levels of probability, management acquires all relevant information concerning the uncertain set of circumstances. An accrual of a loss occurs when it is both probable that an asset has been impaired or a liability has been incurred and when the amount of loss can be reasonably estimated.

As discussed in Note 15 to the Company s consolidated financial statements, legal proceedings are pending or threatened against the Company, its subsidiaries as well as their respective indemnities. Except as discussed in Note 15:

management has not concluded that it is probable that a loss has been incurred in any pending litigation;

management is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of pending litigation; and

accordingly, management has not provided any amounts in the consolidated financial statements for unfavorable outcome, if any.

As discussed in Note 15, the Company has accrued $2.5 million for potential losses on pending litigation, where in management s best judgment, these losses are both probable and reasonably estimated. These estimates are based on current circumstances of pending matters, and, although management believes the loss recognized is appropriate, circumstances could change resulting in a different amount of loss. The losses accrued are in most part based on various settlement negotiations, which began in the fourth quarter of 2003.

The present litigation environment is substantially uncertain, and it is possible that the Company s consolidated results of operations, cash flows or financial position could be materially affected by unfavorable outcomes or settlements of certain pending litigation. All such cases are, and will continue to be, vigorously defended. However, the Company and its subsidiaries may enter into discussions in an attempt to settle particular cases if it is in the best interests of the Company s stockholders to do so.

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Accounting for Impaired Assets. Statement of Financial Accounting Standard No. 144 (SFAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets, requires long-lived assets to be sold to be classified as held for sale when certain criteria are met. A long-lived asset classified as held for sale is measured at the lower of its carrying amount or fair value less cost to sell and no longer depreciated while it is classified as held for sale. As discussed in Note 5 to our consolidated financial statements, the Company has classified three properties as held for sale. Consequently, the Company incurred a loss of $928,397 on these assets in transferring them to held for sale.

The Company used estimates in determining the fair values of these assets and, although the Company believes the fair values established are reasonable, it is possible that the Company s results of operations, cash flows or financial position could be materially affected by the eventual sale of the assets.

FINANCIAL CONDITION

General

The Company s total assets at December 31, 2003 were $558.6 million, a decrease of $9.0 million (1.6%) from $567.6 million at December 31, 2002. The Company continued to experience declines in net loans of $47.6 million due to pay-offs in the loan portfolio, the lack of new loan growth and increased allowance for loan losses. The Company also experienced a $5.6 million (1.2%) decline in deposits from December 31, 2002 to December 31, 2003, primarily due to management s decision not to pursue higher priced certificates of deposits. Management s decision was based upon our reduced funding needs resulting from the decline in loans, as well as our focus on building profitable relationships. Funding is not currently needed for liquidity at the Company s subsidiary, Community Bank. Noninterest-bearing deposits increased $3.4 million (6.4%) from December 31, 2002 to December 31, 2003, and interest-bearing deposits decreased by $8.8 million (2.2%) during that same period.

Earning Assets

The earning assets of the Company are mainly comprised of:

- loans;
- investment securities;
- interest-bearing balances in other banks; and
- federal funds sold.

The Company s average total assets in 2003 were $556.6 million, representing a decrease of $72.9 million, or 11.6%, from average total assets of $629.5 million in 2002. Average total assets decreased $96.0 million, or 13.2% from $725.5 million in 2001 primarily as the result of ten branch divestitures in the first and second quarters of 2002. Average earning assets were $488.2 million, $526.0 million and $530.7 million in each of 2003, 2002 and 2001, respectively, accounting for approximately 87.7%, 83.6% and 73.1% of the Company s average total assets for the respective years. Average earning assets decreased in 2003 and 2002 because of the branch divestitures described above.

Average loans, excluding those associated with discontinued operations, net of unearned income, were $330.9 million, $382.1 million and $398.5 million, representing 67.8%, 72.6% and 75.1% of average earning assets during 2003, 2002 and 2001, respectively. Average loans decreased in 2003 and 2002 primarily because of lack of new loan volume and other factors, including contractual and early payments, coupled with charge-offs and foreclosures. Average investment securities for the Company were $130.1 million in 2003, representing 26.6% of average earning assets for the year and an increase of $13.5 million, or 11.6%, from the average investment securities for 2002. This increase was due to the Company s reinvestment of funds resulting from the decline in loans into investment securities. The Company s average investment securities were $116.6 million in 2002 and represented 22.2% of average earning assets in 2002, compared to 21.5% in 2001. The change in the mix of loans and securities has been attributable to the decrease in loans described above. Average federal funds sold as a percent of average earning assets was 4.9%, 4.6% and 3.4%

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for 2003, 2002 and 2001, respectively. The decrease in average federal funds from $24.4 million to $23.9 million in 2003 was related to the increased securities investments. The other earning asset categories accounted for less than 3.0% of average earning assets for all three periods.

Cash and amounts due from banks increased $14.4 million during 2003, from $16.0 million at December 31, 2002 to $30.4 million at December 31, 2003. The significant increase experienced by the Company in 2003 is due primarily to earnings credit rates, which are applied to balances held in the Company s correspondent bank accounts that are maintained with other banks. The Company receives credits based on its balances at these correspondent banks, and the credits are used to offset the service charges experienced by the Company. These earnings credit rates are currently higher than the federal funds sold rates. The Company, therefore, increased its balances in its main correspondent account during 2003 to take advantage of the better rate. The Company ultimately received a larger credit against the service charges it would have paid compared to the interest income it otherwise would have received had the funds been held in federal funds sold.

Loans comprise the largest single category of the Company s net assets. Total loans, net of unearned income, decreased approximately $43.0 million, or 12.0%, in 2003, to $316.2 million at December 31, 2003. In 2002, total loans decreased approximately $142.3 million, or 28.4%, to approximately $359.2 million at December 31, 2002, from $501.5 million at December 31, 2001. The Company has experienced a significant decrease in loans since December 31, 2001 of $183.5 million. The largest decline of $142.3 million was during 2002 when the Company sold ten of its branch bank offices. During 2003, loans declined $43.0 million. Loan foreclosures of $6.9 million, other asset foreclosures of $2.5 million, charge-offs of $6.8 million and transfers to held for sale of $1.8 million, contributed to $18.0 million of this decline. The remainder was due to contractual payments and prepayments received, net of new loans booked.

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The following table shows the classification of loans by major category at December 31, 2003, and at the end of each of the preceding four years:

LOAN PORTFOLIO

	December 31,									
	2003		2002		2001		2000		1999	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)									
Commercial, financial and agricultural	**$ 73,746**	**23.3%**	$ 101,841	28.3%	$ 146,210	29.1%	$ 140,773	26.6%	$ 124,245	24.9%
Real estate - construction	**3,386**	**1.1**	2,017	0.6	3,126	0.6	5,429	1.0	6,470	1.3
Real estate - mortgage	**176,097**	**55.7**	174,775	48.7	233,216	46.5	236,592	44.8	224,129	44.9
Installment loans to individuals	**62,826**	**19.9**	80,596	22.4	119,031	23.8	145,673	27.6	144,453	28.9
Unamortized premiums in loans	**184**									
Unearned income	**(32)**		(45)		(64)		(151)		(571)	
Loans, net of unearned income	**316,207**	**100.0%**	359,184	100.0%	501,519	100.0%	528,316	100.0%	498,726	100.0%
Allowance for loan losses	**14,358**		9,784		7,292		7,107		2,603	
Net loans	**$ 301,849**		$ 349,400		$ 494,227		$ 521,209		$ 496,123	

The following table provides maturities of certain loan classifications and an analysis of these loans maturing in over one year as of December 31, 2003:

SELECTED LOAN MATURITY AND INTEREST RATE SENSITIVITY

	Maturity				Rate Structure for Loans Maturing Over One Year	
	One Year or Less	Over One Year Through Five Years	Over Five Years	Total	Predetermined Interest Rate	Floating or Adjustable Rate
			(In thousands)			
Commercial, financial and agricultural	$ 23,245	$ 17,564	$ 32,937	$ 73,746	$ 14,129	$ 36,372
Real estate - construction.	2,529	99	758	3,386	180	677
Total	$ 25,774	$ 17,663	$ 33,695	$ 77,132	$ 14,309	$ 37,049

During the fourth quarter of 2003, the Company began a process of identifying certain nonperforming loans it wanted to sell. As these loans are identified, they are classified as held for sale and written down to fair market value based on bids received from prospective purchasers. At December 31, 2003, the net value of loans that had been transferred to held for sale was $1.8 million. The write down on these loans were $1.9 million and is included in loans charged off in the allowance for loan losses.

Nonperforming Assets and Past Due Loans

The Company s nonperforming assets are comprised of:

nonaccruing loans;

loans 90 days past due or greater;

restructured loans;

nonaccruing securities; and

other real estate owned.

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The Company s total nonperforming assets as of December 31, 2003 were $24.1 million, comprised primarily of nonaccruing loans, represented an increase of $1.8 million, or 8.1%, over the $22.3 million of nonperforming assets at December 31, 2002. This increase is due to several factors, including the poor asset quality in the Company s loan portfolio and the migration of loans past due less than 90 days into more than 90 days past due, nonaccruing loans or the conversion of those loans into other real estate owned. The total nonperforming assets at December 31, 2002 increased approximately $9.8 million, or 78.4%, to approximately $22.3 million, from approximately $12.5 million at December 31, 2001. This significant increase during 2002 also was the result of poor asset quality in the loan portfolio. While increases in total nonperforming assets during 2002 were, in many cases, due to increased efforts to initially recognize problem assets, increases in 2003 were due not only to continuation of these efforts, but also to the migration of poor quality loans to nonperforming status.

At December 31, 2003, total nonaccruing loans amounted to $14.1 million, an increase of $4.0 million, or 39.6%, over total nonaccruing loans at December 31, 2002 of $10.1 million. This increase was due to a large amount of past due loans migrating to nonaccruing status. During 2002, nonaccruing loans increased 71.2%, from $5.9 million at December 31, 2001 to $10.1 million at December 31, 2002. This increase primarily resulted from a large amount of loans being reclassified as nonaccruing in connection with the Company s focusing more effort on recognizing problem loans and implementing more stringent credit standards. Loans past due 90 days or more decreased $1.1 million, or 47.8%, from $2.3 million at December 31, 2001 to $1.2 million at December 31, 2002. Loans past due 90 days as of December 31, 2003 was $0.6 million, representing a decrease of $0.6 million, or 50.8%, from $1.2 million at December 31, 2002, primarily as a result of the Company s renewed focus on past due credits to bring more attention and frequency to the oversight of delinquent loans. The Company has recognized weaknesses in its asset quality and has increased its credit standards through various enhancements and initiatives including but not limited to the following:

- improvements in lending personnel and credit administration process;
- establishment of a Special Assets division to focus on nonperforming loans, other real estate owned and other foreclosed assets;
- centralized loan processing to ensure that loan policies and procedures and documentation are applied consistently and accurately;
- improved collection and analysis of updated financial data on borrowers;
- tighter lending authority limits for lenders;
- improved credit training, risk selection and loan underwriting;
- renewed focus on reducing past due loans;
- ongoing improvements and updates to the Company s overall loan policies; and
- written, comprehensive strategies and policies required for all problem assets above $150,000.

Although the Company presently believes that it has identified the significant problems in its loan portfolio, it can give no assurance that continued deterioration of the loan portfolio will not occur. However, it is the Company s policy to adequately reserve for losses in the loan portfolio. See Results of Operations Provision for Loan Losses, Net Charge-Offs and Allowance for Loan Losses for more information and detail below.

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The following table summarizes the Company s nonperforming assets at December 31 during each of the last five years:

NONPERFORMING ASSETS

	December 31,				
	2003	**2002**	**2001**	**2000**	**1999**
	(Dollars in thousands)				
Nonaccruing loans	**$ 14,138**	$ 10,099	$ 5,859	$ 1,877	$ 2,709
Loans past due 90 days or more	**611**	1,241	2,346	2,571	1,332
Restructured loans	**2,390**	3,244			
Total nonperforming loans.	**17,139**	14,584	8,205	4,448	4,041
Other real estate	**6,945**	7,676	4,287	1,881	766
Total nonperforming assets	**$ 24,084**	$ 22,260	$ 12,492	$ 6,329	$ 4,807
Ratios:					
Allowance for loan losses to total nonperforming assets	59.62%	43.95%	58.37%	112.29%	54.15%
Total nonperforming loans to total loans	5.42	4.06	1.64	0.84	0.81
Total nonperforming assets to total assets	4.31	3.92	1.64	0.89	0.71

If nonaccrual loans had performed in accordance with their original contractual terms, gross interest income on these loans would have been an estimated $0.9 million for the year ended December 31, 2003, compared to $0.6 million and $0.3 million for the years ended December 31, 2002 and 2001, respectively.

Investment Portfolio

The composition of the Company s investment securities portfolio reflects the Company s investment strategy of maximizing portfolio yields subject to risk and liquidity considerations. The Company s entire portfolio is classified as available for sale. The primary objectives of the Company s investment strategy are to maintain an appropriate level of liquidity and to provide a tool to assist in controlling the Company s interest rate position, while at the same time producing adequate levels of interest income. Management of the maturity of the portfolio is necessary to provide liquidity and to reduce interest rate risk. During 2003, gross investment securities sales, calls and pay downs were approximately $113.5 million, and maturities were approximately $18.4 million, compared to $88.6 million and $15.0 million, respectively, in 2002, and $86.4 million and $2.5 million, respectively in 2001. The increase in gross investment securities in 2003 was due to decreases in the loan portfolio, and the resulting reinvestment of funds that would otherwise have been employed in the loan portfolio into these investment securities. The increase in gross investment securities in 2002 resulted from similar circumstances, but partially was offset by declines in deposits due to the branch sales early that year. The increase in maturities in 2003 primarily was due to short term investments made during the year to cover fluctuations in needs for pledging requirements that matured during the year.

Net gains realized on investment security sales totaled approximately $1.1 million in 2003, compared to $653,000 during 2002, and $1.3 million in 2001. At December 31, 2003, gross unrealized gains in the Company s investment portfolio were approximately $693,000, compared to $2.7 million at December 31, 2002, and approximately $486,000 at December 31, 2001. The Company s gross unrealized losses amounted to approximately $1.7 million at December 31, 2003, $227,000 at December 31, 2002, and approximately $893,000 at December 31, 2001. These fluctuations in the gross unrealized gains and losses in the Company s investment portfolio resulted from changing bond prices. Unrealized losses on a bond occur when the bond s yield is less than the company could currently receive in the market. The opposite is true when a bond is paying more yield than the current market resulting in unrealized gains.

Mortgage-backed securities have varying degrees of risk of impairment of principal, compared to U.S. Treasury and U.S. government agency obligations, which are considered to contain virtually no default or prepayment risk for the Company. Impairment risk is primarily associated with accelerated prepayments, particularly with respect to longer maturities purchased at a premium and interest-only strip securities. At each of December 31, 2003, 2002 and 2001 the Company s mortgage-backed securities portfolio had no interest-only strips, and the amount of unamortized premium on mortgage-backed securities was $2.2 million at December 31, 2003, and $1.7 million and $929,000 at December 31,

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2002 and December 31, 2001, respectively. As prepayment rates on mortgage-backed securities change, the speed at which unamortized premiums are amortized will change as well, in order to amortize the premium over the expected life of the security. This change will be reflected in the overall yield on the security. The recoverability of the Company s investment in mortgage-backed securities is reviewed periodically by management, and, if necessary, appropriate adjustments for impaired value are made to income.

The carrying amount of investment securities at the end of each of the last three years is set forth in the following table:

INVESTMENT PORTFOLIO

	December 31,		
	2003	**2002**	**2001**
		(In thousands)	
U. S. Treasury and agency securities	**$ 61,216**	$ 6,523	$ 16,948
Mortgage-backed securities	**86,623**	107,534	90,647
State and municipal securities	**6,427**	7,056	11,684
Federal Home Loan Bank Stock	**2,005**	2,788	2,400
Total investment securities	**$ 156,271**	$ 123,901	$ 121,679

Total investment securities increased approximately $32.4 million, or 26.2%, from approximately $123.9 at December 31, 2002, to approximately $156.3 million at December 31, 2003. This increase primarily was due to increased security purchases, as a means of employing the funds from payments received on loans, which exceeded new loan growth. In 2002, total investment securities increased $2.2 million, or 1.8%, from approximately $121.7 million at December 31, 2001, to approximately $123.9 million at December 31, 2002. This increase resulted from similar circumstances, but partially was offset by declines in deposits and the cash outflow as a result of the branch sales in 2002. At December 31, 2003, non-taxable investment securities were $6.4 million, representing a decrease of $700,000 in 2003 related to maturities of these securities and no reinvestment into additional non-taxable investment securities as a result of the Company operating with taxable losses that would limit the potential benefit of these investments. During 2002, non-taxable investment securities decreased $4.6 million, or 39.3%, from $11.7 million at December 31, 2001, to approximately $7.1 million.

The composition of the Company s investment securities portfolio changed during 2003, primarily as the result of the Company selling certain collateralized mortgage obligations due to (i) their price volatility, (ii) their high extension risk in an increasing rate environment, and (iii) their high prepayment risk in a decreasing rate environment, and also as the result of the Company reinvesting the resulting funds into government agency and mortgage-backed securities with shorter average maturities. At December 31, 2003, U.S. government and agency securities represented 94.6% of the Company s total investment securities portfolio, compared to 92.1% at December 31, 2002 and 88.4% at December 31, 2001, while state and municipal securities represented 4.1%, 5.7% and 9.6% of the investment securities portfolio at December 31, 2003, 2002 and 2001, respectively. In 2003 and 2002, as investable funds increased due to diminished loan demand, and as bonds were redeemed prior to maturity, Community Bank invested more heavily in mortgage-backed securities to enhance cash flow and maximize yield. In 2003, as these conditions continued, Community Bank maintained its focus on enhancing cash flow and increasing yield, and also became more focused on risk factors in the portfolio and managing those risks to pursue desired results.

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The maturities and weighted average yields of the investments in the December 31, 2003 portfolio of investment securities are presented below. The weighted average maturity of the investment portfolio was 5.12 years at December 31, 2003, compared to 6.21 years at December 31, 2002 and 5.20 years at December 31, 2001, with an average yield of 4.00%, 5.78% and 6.05% at December 31, 2003, 2002 and 2001, respectively. Mortgage-backed securities have been included in the maturity table based upon the guaranteed payoff date of each security.

INVESTMENT PORTFOLIO MATURITY SCHEDULE

	Maturing							
	Within One Year		After One But Within Five Years		After Five But Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	(Dollars in thousands)							
December 31, 2003:								
Securities - all available-for-sale:								
U. S. Government agencies	$ 5,025	4.80%	$ 50,273	2.64%	$ 30,987	3.68%	$ 61,554	4.92%
State and municipal securities					375	4.45	6,052	5.07
Equity securities							2,005	
	$ 5,025	4.80	$ 50,273	2.64	$ 31,362	3.69	$ 69,611	4.79

With the exception of some securities issued by U.S. Government agencies, the Company held only one municipal bond, issued by Hartselle Utilities, the $4.5 million amortized cost of which exceeded 10% of the Company s consolidated stockholders equity on December 31, 2003.

Federal funds sold decreased $9.7 million, or 40.4%, during 2003, from $24.0 million at December 31, 2002 to $14.3 million at December 31, 2003, as a result of the Company s continued efforts to earn higher yields by keeping excess funds in what the Company believes to be suitable investment securities. Federal funds sold decreased $6.0 million, or 20.0%, during 2002, from $30.0 million at December 31, 2001 to $24.0 million at December 31, 2002. This decrease resulted from excess funds being maintained at levels higher than normal at the end of 2001 in anticipation of cash outflows that were expected on the branch sales in early 2002.

The balance of interest-bearing deposits held by the Company with other banks was $260,000 at December 31, 2003, and $200,000 at each of December 31, 2002 and 2001.

Deposits

Dividends from Community Bank have historically been the Company s primary source of funds, and Community Bank s primary source of funds for dividends comes from its deposits.. The Company presently does not anticipate geographic expansion for deposit growth at any time in the foreseeable future. Rather, the Company s intent is to expand its consumer base, and deposits generally, by attracting new customers in the Company s existing markets. To achieve future deposit growth, the Company intends to enhance existing products and emphasize better customer service.

During 2003, the Company s average total deposits decreased approximately $15.1 million, or 3.2%, from $467.5 million at December 31, 2002, to approximately $452.4 million at December 31, 2003. During 2002, the Company s average total deposits increased approximately $4.4 million, or 1.0%, from $463.1 million at December 31, 2001. The Company s total deposits at December 31, 2003 were $453.9 million, a decrease of $5.6 million from December 31, 2002 due to the Company s lowering high priced deposit rates thus losing some volatile deposits.

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The following table presents the average deposit balances and the average rates paid for each of the major classifications of deposits for the 12 month periods ending December 31, 2003, 2002 and 2001, and excludes averages associated with discontinued operations:

	Average Deposit Balances and Rates Paid					
	2003		2002		2001	
	Average Balance	Average Rate Paid(2)	Average Balance	Average Rate Paid(2)	Average Balance	Average Rate Paid(2)
	(Dollars in thousands)					
Noninterest-bearing demand	**$ 55,463**	**0.00%**	$ 56,994	0.00%	$ 57,347	0.00%
Interest-bearing demand	**86,053**	**1.62**	79,386	2.17	73,301	4.42
Savings	**63,464**	**1.47**	56,606	2.04	48,884	4.14
Time	**247,417**	**3.24**	274,552	3.81	283,571	5.37
Total (1)	**$ 452,397**	**2.60**	$ 467,538	3.25	$ 463,103	5.05

(1) The rate paid on total average deposits represents the rate paid on total average interest-bearing deposits only.
(2) Average rates paid are computed on expense and average balances from continuing operations.

The Company s average interest-bearing deposits decreased $13.6 million, or 3.3%, in 2003 from $410.5 million at December 31, 2002 to $396.9 million at December 31, 2003. This decrease occurred in time deposits and was partially offset by increases in interest-bearing demand and savings deposits. Average interest-bearing deposits increased in 2002 by $4.7 million, or 1.2%, from $405.8 million at December 31, 2001. Average savings deposits and average time deposits increased 12.1% and decreased 9.9%, respectively, during 2003, compared to increases of 15.8% and decreases of 3.2%, respectively, during 2002. The movement in both savings and time deposits during 2003 and 2002 related to the current low interest rate environment where consumers chose to move their deposit money from longer term time deposits to shorter term savings deposits in anticipation of an upward rate movements. Average noninterest-bearing demand deposits decreased 2.6% during 2003 compared to a decrease of 0.6% in 2002. Total average deposits increased 1.0% in 2002 and decreased 3.2% in 2003, which decrease related to the loss of more volatile time deposits as the Company lowered its rates paid on time deposits. The two categories of the Company s lowest cost deposits, noninterest-bearing demand deposits and interest-bearing demand deposits, comprised the following percentages of the Company s total average deposits during 2003, 2002 and 2001, respectively: (i) 12.3%, 12.2% and 12.4% of average noninterest-bearing demand deposits; and (ii) 19.0%, 17.0% and 15.8% of average interest-bearing demand deposits. Of total time deposits at December 31, 2003, approximately 24.6% were large denomination certificates of deposit and other time deposits of $100,000 or more, down from 26.0% at December 31, 2002.

The maturities of the time certificates of deposit and other time deposits of $100,000 or more issued by the Company at December 31, 2003 are summarized in the table below:

MATURITIES OF TIME DEPOSITS OF $100,000 OR MORE

December 31, 2003

	Time Certificates of Deposit	Other Time Deposits	Total
		(In thousands)	
Maturing in three months or less	$ 6,644	$ 15,290	$ 21,934
Maturing in over three through six months.	7,540		7,540
Maturing in over six through twelve months	9,122		9,122
Maturing in over twelve months	30,656		30,656
Total	$ 53,962	$ 15,290	$ 69,252

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Borrowed Funds

Borrowed funds consist primarily of short-term borrowings and long-term debt.

Total short-term borrowings decreased $1.1 million, or 64.7%, to $0.6 million at December 31, 2003 from $1.7 million at December 31, 2002. Total short-term borrowings in 2002 decreased $2.7 million, or 61.4%.

Community Bank is a member of the Federal Home Loan Bank of Atlanta, or the FHLBA, and, since 1999, has been approved to borrow up to $38.0 million under the FHLBA s Convertible Advance Program. As of December 31, 2003, Community Bank had borrowed the entire $38.0 million available under this program. These borrowings accrue interest at a fixed rate of 5.93% per annum and have a final maturity of March 1, 2010. These borrowings are subject to a call feature upon every quarterly payment date during the life of the obligation. The first call date for this advance was March 1, 2001, and the advance has not been called to date. These borrowings are secured under a blanket lien agreement on qualifying mortgage instruments in Community Bank s loan and investment portfolios. Under this lien agreement, in an event of default, the FHLBA may declare all or any part of the indebtedness and accrued interest, including any prepayment fees, to be immediately due and payable. Included in the list of events of default is the situation where the FHLBA reasonably and in good faith determines that a material adverse change has occurred in the financial condition of Community Bank from that disclosed at the time of the making of any advance or from the condition of Community Bank as most recently disclosed to the FHLBA. The Company s FHLBA long-term debt remained constant at $38.0 million for each December 31, 2003, 2002, and 2001. The Company s other long-term debt decreased $0.4 million, or 11.1%, to $3.2 million at December 31, 2003, from $3.6 million at December 31, 2002, simply as a result of scheduled payments.

Included in the Company s other long-term debt is the Company s promissory note to Mr. Jeffrey K. Cornelius, a former director and officer of Community Bancshares. On October 4, 1994, the Company purchased 115,978 shares of its common stock, including 7,144.384 shares vested under the Company s Employee Stock Option Plan, from Mr. Cornelius at a price per share of approximately $25.00. The Company paid Mr. Cornelius $899,450 in cash, with the balance payable by a subordinated promissory note in the original amount of $2.0 million. The note is subordinated to all Company senior indebtedness, bears interest on the outstanding principal amount at a rate of 7.0% per annum, is payable in 240 equal monthly installments of principal and interest until maturity on October 1, 2014, and may be repaid in whole or in part by the Company at any time without penalty. As of December 31, 2003, the balance was $1.4 million.

In March 2000, the Company completed an offering of $10.0 million of trust preferred securities, pursuant to which:

- the Company organized a Delaware statutory business trust called Community (AL) Capital Trust I, or the Trust, governed by an Amended and Restated Declaration of Trust;

- the Company issued and sold to the Trust approximately $10.3 million in aggregate principal amount of unsecured junior subordinated debentures, or debentures, which were issued under an Indenture, and which represent the sole assets of the Trust;

- the Trust issued and sold:

$10,000,000 of preferred capital securities, or trust preferred securities, representing undivided beneficial interests in the assets of the Trust, to a third party special purpose Company, which in turn pooled the trust preferred securities together with similar securities of other issuers and sold certificates representing interests in that closed-end, unmanaged pool to investors; and the Trust used the proceeds from the sale of the trust preferred securities to the pool to purchase the debentures from the Company; and

$310,000 of its common securities to the Company, which represent all of the Trust s outstanding common securities; and

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pursuant to a Guarantee Agreement, the Company fully and unconditionally guaranteed the payments of all amounts due on the trust preferred securities, which guarantee is limited to the extent the Trust has funds available for payment of distributions.

Both the debentures and the trust preferred securities accrue and pay interest semiannually at a rate of 10 $^{7}/8$% per annum and have a maturity date of March 8, 2030, at which time the principal amount of the debentures becomes due and the trust preferred securities become mandatorily redeemable by the Company. When the Company makes payments to the Trust, as the holder of the debentures, the Trust, in turn, makes payments to the pool, as the holder of the trust preferred securities. The debentures represent the sole asset of the Trust. The debentures and related income statement effects are eliminated in the Company s consolidated financial statements. The Company is entitled to treat the aggregate liquidation amount of the debentures as Tier 1 capital under Federal Reserve guidelines.

The Company may elect to defer payments of interest due on the debentures for up to ten semiannual payment periods. The Company has elected to defer its March 2002, September 2002, March 2003 and September 2003 interest payments and may elect to defer future payments based upon the Company s future liquidity needs when those payments become due. Interest continues to accrue, on a compounded basis, on any interest payments that the Company defers.

On March 8, 2004, the Company elected to defer the then due interest payment on its trust preferred securities, which represented the Company s fifth consecutive semiannual payment deferral. The terms of the indenture governing the debenture permit ten such payment deferrals. As a result of that deferral, on March 8, 2004, the Company had accrued but unpaid interest totaling $3.0 million.

As of December 31, 2003, the aggregate deferred interest payments owed by the Company on the trust preferred securities and the debentures totaled approximately $2.8 million. In accordance with the terms of the indenture, the Company is restricted, during any period of time that the Company has deferred interest payments due upon the debentures, from paying dividends to the Company s stockholders or making payments on any debt that ranks equal with or junior to the debentures.

The trust preferred securities are mandatorily redeemable upon their maturity, or upon their earlier redemption as provided in the indenture. Additionally, the Company has the right to redeem the debentures purchased by the Trust:

in whole or in part, on or after, but not at any time before, March 8, 2010; and

in whole, but not in part, at any time within 90 days following the occurrence and during the continuation of a tax event, capital treatment event or investment company event, as those terms are defined in the indenture.

As specified in the indenture, if the debentures are redeemed prior to maturity, then the redemption price will be a percentage of the principal amount, ranging from 105.438% during the 12 months following March 8, 2010 to 100.00% following March 8, 2020, plus any accrued but unpaid interest due on the debentures at the time of redemption. If the debentures are redeemed prior to March 8, 2010 following a tax event, capital treatment event or investment Company event, the redemption price will be the greater of (i) 100% of the principal amount of debentures redeemed and (ii) the present value of the remaining principal and interest payments between the redemption date and March 8, 2010, plus, in either case, any accrued but unpaid interest due on the debentures at the time of redemption.

The Company sponsors an Employee Stock Ownership Plan, or ESOP, to provide the Company s employees with a means of owning its common stock. An employee becomes an eligible participant in the ESOP on June 30 or December 31 of any given year after completing 12 months of employment during which the employee is credited with 1,000 or more hours of service. Contributions by the Company to the ESOP are made at the discretion of the Company s board of directors, but may not be less than the amount required to cover any debt service due on the ESOP s loan, which is described below.

On November 3, 1993, the ESOP borrowed $1.2 million from Colonial Bank to purchase shares of the Company s common stock, and the Company guaranteed all obligations of the ESOP under this ESOP loan. The ESOP loan has

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been amended from time to time, including additional borrowings, and, as of December 31, 2003, $1.8 million remained outstanding under the ESOP note, which amount was secured by 123,111 shares of the Company s common stock previously purchased and held by the ESOP. As the ESOP note is paid off, the lender releases shares from the pledge, and these shares are allocated to ESOP participants annually. At December 31, 2003, the ESOP held 395,631 shares of the Company s common stock that were not subject to the pledge.

Under the terms of the Company s guaranty of the ESOP loan, Colonial has contractual provisions which provide it can hold as collateral for the ESOP loan any of the Company s property that it otherwise from time to time holds. The Company previously had a line of credit with Colonial Bank, unrelated to the ESOP, which was secured by the Company s pledge of all of the outstanding shares of the common stock of the Bank. Although the Company has paid off this line of credit, Colonial Bank at December 31, 2003 continued to hold all of the shares of the common stock of the Bank. Accordingly, if the ESOP or the Company had defaulted on the ESOP loan from Colonial Bank, Colonial Bank could have sought to foreclose upon all the outstanding Bank stock, which is the Company s primary asset and primary source of earnings.

On February 11, 2004, the ESOP replaced the ESOP loan from Colonial Bank with a loan directly from the Company. As a result, Colonial Bank released the shares of the common stock of Community Bank that it previously held as collateral to secure the Company s guaranty of the ESOP loan with Colonial Bank. As a result of this refinancing of the ESOP loan, the ESOP had borrowings from the Company of $1.7 million at February 11, 2004. The new ESOP loan from the Company bears interest at an adjustable rate equal to the prime rate of interest, with a maturity date of November 16, 2010. This loan is secured by the ESOP s pledge of unallocated shares of the Company s common stock held by the ESOP.

The ESOP loan bears interest at a floating rate at the prime rate of interest. As of December 31, 2003, the interest rate for the note was 4.0%. Principal and interest payments on the ESOP loan were due monthly through November 16, 2010, with the remaining principal and interest, if any, due upon that date. The ESOP loan may be prepaid in whole or in part without penalty under the Colonial loan agreement The Company made contributions to the ESOP that enabled the ESOP to make payments due under the ESOP loan and to make cash distributions to eligible participants. The Company made contributions of approximately $934,000 during the year ended December 31, 2003, $604,000 during the year ended December 31, 2002, and $406,000 during the year ended December 31, 2001.

Under the terms of the ESOP, after a person ceases to be an employee of Community Bancshares and/or its affiliates, that person is no longer eligible to participate in the ESOP. In that case, the person may demand to receive, as a lump sum payment, all amounts accrued to his benefit under the ESOP as of the end of the year immediately preceding that person s termination of employment with the Company.

Mr. Kennon R. Patterson, Sr., whose employment with the Company terminated in January 2003, has demanded to receive from the ESOP a total of approximately $298,000, representing the total amount accrued by Mr. Patterson during his participation in the ESOP. To enable the ESOP to make this lump sum cash payments, the Company may be required to contribute cash to the ESOP in addition to its ongoing requirement to make contributions to service the ESOP debt. As of December 31, 2003, the Company had denied Mr. Patterson s request for payment and was evaluating its obligations to Mr. Patterson in light of Mr. Patterson s recent indictment and the requirements of law applicable to ESOPs.

The Company s long-term debt consisted of various commitments with scheduled maturities from one to 20 years. The following table sets forth expected debt service for the next five years based on interest rates and repayment provisions as of December 31, 2003:

MATURITIES OF LONG-TERM DEBT

	2004	2005	2006	2007	2008
			(In thousands)		
Interest on indebtedness	$ 160	$ 139	$ 118	$ 95	$ 72
Repayment of principal	432	453	474	497	423
	$ 592	$ 592	$ 592	$ 592	$ 495

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Liquidity

Liquidity is defined as the ability of a Company to convert assets into cash or cash equivalents without significant loss. Liquidity management involves maintaining the Company s ability to meet the day-to-day cash flow requirements of Community Bank s customers, whether they are depositors wishing to withdraw funds or borrowers requiring funds to meet their credit needs. Without proper liquidity management, the Company would not be able to perform the primary function of a financial intermediary and would, therefore, not be able to meet the production and growth needs of the communities it serves.

The primary function of asset and liability management is not only to assure adequate liquidity in order for the Company to meet the needs of its customer base, but to maintain an appropriate balance between interest-sensitive assets and interest-sensitive liabilities so that the Company can also meet the investment objectives of its stockholders. Daily monitoring of the sources and uses of funds is necessary to maintain an acceptable cash position that meets both its customers needs and its stockholders objectives. In a banking environment, both assets and liabilities are considered sources of liquidity funding and both are, therefore, monitored on a daily basis.

The following is a discussion of the Company s current cash flows and liquidity. The Company experienced an approximate $4.7 million increase in cash and cash equivalents during the 2003, due primarily to cash flows from operating activities. Cash provided by operating activities during 2003 was $6.6 million, compared to $1.8 million and $9.8 million for the years ended December 31, 2002 and December 31, 2001, respectively. Investing activities used cash of $5.2 million during 2003, mostly through securities purchases net of cash inflows from sales, calls, pay downs and maturities of securities, and loan payments from customers. Financing activities provided $3.4 million of cash and cash equivalents during 2003, compared to its use of $22.8 million and its providing $18.1 million during each of 2002 and 2001, respectively. Certificates of deposits decreased $52.7 million during 2003, but this was mostly offset by increases in cash from the growth of demand deposits, NOW deposits, and other savings deposits totaling $47.2 million. The issuance of common stock, net of transaction costs brought cash inflow of $10.4 million.

Community Bank represents the Company s principal operating subsidiary and source of earnings. Dividends paid by Community Bank historically have been the primary source of funds available to the Company, to pay expenses, service debt and pay dividends to stockholders. Generally, the Federal Reserve Act, Section 23A, limits loans and extensions of credit from banks to their affiliated holding companies. The Company also receives cash from its subsidiaries for its portion of tax benefit on intercompany income tax settlements. The intercompany tax settlements, however, are only possible if the subsidiaries generate taxable income sufficient to pay income taxes. Community Bank discontinued paying the Company a management fee in 2003. As described previously under Business Our Regulatory Environment and - Our Current Regulatory Restrictions, the Bank currently cannot pay dividends to the Company without the prior approval of the regulatory authorities. As a result of these restrictions, the Company has been unable to pay when due interest on its trust preferred securities, of which approximately $2.8 million has been accrued by December 31, 2003. As of December 31, 2003, the ESOP was current on its loan from Colonial Bank, which was guaranteed by the Company.

In addition to debt service, as described above, the Company also will expend capital to settle, resolve and pay legal and other professionals to assist it in defending against, the litigation to which it presently is subject, as described in Note 15 to the Company s consolidated financial statements included in this report. The Company also may apply cash to maintain and improve capital levels at the parent Company and at each subsidiary, as described below under Capital Resources. The Company also may use cash if it determines to review and possibly sell any of its branches that do not contribute to the Company s improved operations, or if it determines to resolve its non-performing assets.

The Company s management has evaluated various alternatives to improve its cash flows, liquidity, and capital position. Since the Bank cannot make payments to the Company without prior regulatory approval, the Company has relied, since April 2001, upon income tax refunds to fund its obligations. Such refunds have resulted from carrybacks to prior years, which have been largely utilized and will be limited in the future. Accordingly, to pay its ordinary expenses, as well as, debt service requirements and the expenses of litigation and restructuring, it was determined in late 2003 the Company needed additional capital. In addition, management believed, that as part of its plan to restore the Bank s profitability and grow in its core markets, it needed capital in order to dispose of other real estate owned and non-performing assets, to rationalize and/or sell certain branches, to refinance or repay approximately $3.2 million of long-term indebtedness, and to seek a restructuring of approximately $12.6 million of outstanding trust preferred securities obligations. Management believed that new capital was needed for these purposes.

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As a result, during the fourth quarter of 2003, the Company commenced a private placement of its common stock, and, as of December 31, 2003, the Company had sold 2,151,552 shares of its common stock at a price of $5.35 per share, resulting in net proceeds of approximately $10.4 million. In addition, the Company granted to those investors who initially purchased shares in the offering prior to December 31, 2003, as well as to one investor who purchased an additional 40,345 shares after December 31, 2003, an option to exchange by December 31, 2008, in whole but not in part, the shares of the Company s common stock purchased in the offering for shares of the Company s newly designated Series 2003 noncumulative preferred stock. The Company completed this offering on February 20, 2004, selling an additional 1,586,771 shares of its common stock for $7.9 million of additional net proceeds, resulting in the sale of a total of 3,738,323 shares for total net proceeds from the offering of $18.3 million.

The Series 2003 noncumulative preferred stock has a liquidation preference equal to the aggregate purchase price of the 2,191,897 shares of common stock initially purchased in the offering, and each whole share of the Series 2003 noncumulative preferred stock will have a liquidation preference of $500,000. The Series 2003 noncumulative preferred stock has, among other things, the following designations:

- The Series 2003 noncumulative preferred stock has terms consistent with the Company s Tier 1 capital treatment for regulatory purposes;
- The Series 2003 noncumulative preferred stock is noncumulative and is not entitled to the payment of, or otherwise accrue, any dividends;
- The Series 2003 noncumulative preferred stock is not entitled to the benefit of any sinking fund or similar arrangement;
- The Series 2003 noncumulative preferred stock has no preemptive, preferential or other right to purchase, subscribe for or convert into any other of the Company s securities;
- The Company is not required to purchase the shares of Series 2003 noncumulative preferred stock;
- Holders of the Series 2003 noncumulative preferred stock do not have registration rights requiring the Company to register the shares of the Series 2003 noncumulative preferred stock; and
- The Series 2003 noncumulative preferred stock has no voting power with respect to any Company matters, except in the case of a merger or a significant acquisition or sales transaction, in which case, the Series 2003 noncumulative preferred stock will be entitled to one vote per whole share, and will vote together, as one class, with the holders of our common stock.

The complete terms of the Series 2003 noncumulative preferred stock are set forth in the Certificate of Designation of the Series 2003 Noncumulative Preferred Stock of Community Bancshares, Inc., which the Company has filed with the Secretary of State of the State of Delaware as part of its Certificate of Incorporation.

In connection with the offering, the Company entered into an engagement letter with FIG Partners, L.L.C., an affiliate of Burke Capital Group, L.L.C., pursuant to which FIG Partners agreed to serve as placement agent for the offering, and the Company agreed to grant to FIG Partners, upon the closing of the offering, a warrant to purchase shares of the Company s common stock. In connection with the closing of the offering on February 20, 2004, the Company became obligated to issue to FIG Partners a warrant to purchase up to 140,187 shares of the Company s common stock at an exercise price of $5.89 per share. The warrant expires on February 20, 2008, and, until that date, may be exercised either in cash or pursuant to a cashless exercise.

As of December 31, 2003, the Company had used approximately $5.1 million of the net proceeds from this offering as follows:

- $3.0 million to replace capital in Community Bank; and

- $2.1 million to capitalize Community Funding which will purchase certain nonperforming assets from Community Bank thus lowering its level of nonperforming assets.

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In addition, the Company will continue to use the remaining proceeds from this offering for general corporate purposes and other capital needs, in each case as permitted by the Company s regulatory authorities and as determined by the Company s Board of Directors and/or management to be in the best interests of the Company and its stockholders.

Capital

The Company s total stockholders equity at December 31, 2003 was 6.32% of total assets, as compared to 7.10% at December 31, 2002 and 5.28% at December 31, 2001. The decrease in 2003 is primarily a result of net operating losses of $13.0 million which were mitigated by $10.4 million of net capital raised in the fourth quarter of 2003. The increase in 2002 is primarily due to a decrease in total assets as a result of branch divestures earlier in that year.

The following table summarizes the equity-to assets and dividend payout ratios for each of the last three years:

CAPITAL GROWTH (REDUCTION) RATIOS

	Years ended December 31,		
	2003	**2002**	**2001**
Dividend payout ratio.	**0%**	0%	0%
Average equity to average assets ratio	**6.64**	6.81	5.92

The Company s return on average assets ratio, which is computed by dividing net income (loss) by average assets was (2.35)%, 0.14% and (0.20)% for 2003, 2002 and 2001, respectively. The decrease in 2003 was reflective of the net loss incurred of $13.1 million. The increase in 2002 was due to the net income of approximately $904,000 in 2002, compared to a net loss of approximately $1.4 million in 2001, coupled with a 13.2% decrease in average assets during 2002 to approximately $629.5 million.

The Company s return on average equity ratio, which is computed by dividing net income (loss) by average stockholders equity, was (35.42)%, representing a decrease from 2002 due again to the net loss of $13.1 million, and increased during 2002 to 2.11% from (3.31)% in 2001. The increase in 2002 was due to net income of approximately $904,000 made by the Company in 2002, compared to the net loss of approximately $1.4 million in 2001, which was coupled with a slight decrease in average stockholders equity to approximately $42.8 million during 2002, compared to approximately $42.9 million during 2001.

The Company s dividend payout ratio is determined by dividing the dividends per share by the basic net earnings or loss per share for the relevant period. The Company did not pay dividends in 2003, 2002 or 2001, and, therefore, the payout ratio remained zero.

The Company s average equity to average assets ratio, which is computed by dividing average stockholders equity by average assets, is presented above. The decrease in 2003 resulted from a 13.7% decrease in average equity and an 11.6% decrease in average assets, while the increase in 2002 was due to a 13.2% decrease in average assets during 2002, while average stockholders equity decreased by only 0.2%.

In addition, the Company must satisfy the capital requirements established by the Company s regulatory authorities, as described under Business Our Regulatory Environment and Our Current Regulatory Restrictions.

RESULTS OF OPERATIONS

Net Income and Earnings per share

The Company s net loss of approximately $13.1 million for 2003 represented a decrease of $14.0 million from its net

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income of $0.9 million for 2002, which was a $2.3 million increase from the Company s net loss of approximately $1.4 million for the year ended December 31, 2001. When stated as changes in basic losses per share, the basic earnings per share for the Company in 2003 was $(2.79), a decrease of $2.98 from the 2002 basic earnings per share of $0.19. The earnings per share in 2002 reflected a $0.50 increase from the 2001 basic loss per share of $0.31 experienced by the Company. There are various factors contributing to the $14.0 million decrease in 2003, including the Company experiencing a significant decline in net interest income, an increase in provision for loan losses, a decline in noninterest income and a significant increase in noninterest expenses, all offset by increased income tax benefit recognition, all of which is a part of the Company s continued operations. In addition, the Company experienced a decrease in income from discontinued operations as a result of gains in 2002 from the sale of these operations.

The 2001 consolidated statements of income were restated to appropriately reflect earnings and losses from both continuing and discontinued operations as a result of branch divestitures that occurred in 2002. These statements have also been restated to reflect results of an investigation that commenced in the fourth quarter of 2002 into allegations that the Company had been overcharged on various construction projects. The Company has appropriately recorded impairment losses on premises and equipment and charged them to the period in which the overcharge occurred. Any overcharge which occurred prior to the year ended December 31, 2000 has been appropriately reflected as a prior period adjustment in Retained Earnings. See Note 24 in the notes to consolidated financial statements.

The Company experienced a loss from continuing operations for the year ended December 31, 2003 of $13.1 million and a loss from continuing operations for the year ended December 31, 2002 of $5.0 million. The Company s loss from continuing operations had increased $2.6 million during 2002 from a loss of $2.4 million for the year ended December 31, 2001. The basic loss from continuing operations per common share was $2.79 for the year ended December 31, 2003. The basic loss from continuing operations per common share was $1.08 for the year ended December 31, 2002 as compared to a basic loss from continuing operations per common share for the year ended December 31, 2001 of $0.52. For the year ended December 31, 2002, the Company had income from discontinued operations, due to branch divestitures, of $5.9 million, including a pretax gain on the sale of approximately $8.1 million on the divested branches. Discontinued operations, net of tax, provided approximately $958,000 of income for the year ended December 31, 2001 related to normal operations of those particular branches.

Net Interest Income

Net interest income generally is the principal source of a financial institution s earnings stream and represents the difference or spread between interest income generated from the Company s earning assets and the cost born by the Company on its interest-bearing liabilities. Fluctuations in interest rates as well as volume and mix changes in earning assets and interest-bearing liabilities impact net interest income.

Net interest income for 2003 decreased approximately $4.6 million, or 19.6%, to approximately $18.9 million from approximately $23.5 million in 2002, compared to an increase of approximately $651,000, or 2.6%, during 2002 from approximately $22.9 million 2001. The decrease in the Company s net interest income was due to a decrease in interest income that was partially offset by a decrease in interest expense during the year ended December 31, 2003. The Rate/Volume Variance Analysis table in the following tables provides additional information regarding changes in the Company s interest income, interest expense and net interest income due to changes in average balances and rates.

Interest income for the year ended December 31, 2003 was $33.1 million representing a decrease of $7.6 million, or 18.7%, over interest income during 2002. This decrease was due to 95 basis point decrease in yield coupled with a $37.8 million decrease in average earning assets. Yield attributed to 52.1% of the decrease in interest income while volume attributed to 47.9%. The Company s interest income decreased approximately $6.8 million, or 14.3%, to $40.7 million in 2002 from $47.5 million in 2001. The decrease in 2002 was due to a 122 basis points decrease in the yield on average earning assets during 2002 together with a decrease in the volume of average earning assets. The decreased yield was related to the declining interest rate environment while the decrease in the volume of the Company s average earning assets was due to low loan volumes. For the year ended December 31, 2003, the Company experienced interest income on investment securities of $5.2 million, which was a 22.4% decrease from the interest income on investment securities in 2002 of $6.7 million. The primary reason for the decrease was lower yields as a result of fast prepayments on higher yielding bonds or the sale of these bonds to reduce volatility and the subsequent reinvestment into a lower rate market. The interest income on investment securities decreased 2.4% during 2002, due also to changes in market rates resulting in lower yields on investment securities.

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For the year ended December 31, 2003, the Company s interest expense totaled $14.3 million, representing a decrease of $2.9 million from the interest expense incurred during 2002. This decrease was due mostly to lower rates paid on interest-bearing liabilities. During 2002, the Company s interest expense decreased approximately $7.5 million, or 30.4%, to approximately $17.1 million from approximately $24.6 million in 2001. This significant decrease resulted from a 0.5% decrease in average interest-bearing liabilities outstanding during 2002 due to branch divestitures, while the average rate paid on interest-bearing liabilities during 2002 decreased 157 basis points due to lower market rates. Interest-bearing deposits are the major component of the Company s interest-bearing liabilities, representing 87.7% in 2003, 87.6% in 2002 and 86.1% in 2001 of average total interest-bearing liabilities outstanding. Average interest-bearing deposits outstanding decreased 3.3% during 2003 and increased 1.2% during 2002, respectively, and the rate paid on these average balances reflected a decrease of 65 basis points during 2003 and 180 basis points during 2002. The decrease in interest expense on short-term borrowings for the year ended December 31, 2003 was $33,000 due to lower volumes of such borrowings and interest rates. Interest expense on short-term borrowings during 2002 was stable with that of 2001. The increase in interest expense on long-term debt for the year ended December 31, 2003 was $200,000 due to interest accrued on deferred interest of trust preferred securities. The decrease in interest expense on long-term debt during 2002 occurred despite an increase in the average rate paid of 37 basis points as a result of a 9.8% decline in the average balance for 2002. Interest expense on FHLBA borrowings during 2003 of $2.3 million was stable compared to that of 2002 of $2.3 million, while the decrease in 2002 was due to a 9.5% decrease in the average balance of borrowings outstanding during 2002, even though the average interest rate paid on these borrowings increased 8 basis points during 2002. The average capitalized lease obligations outstanding during 2003 and 2002 were approximately $4.0 million and $4.1 million, respectively, which represented 0.9% of the Company s average total interest-bearing liabilities for both years.

The trend in net interest income is also evaluated in terms of average rates using the net interest margin and the interest rate spread. The net interest margin, or the net yield on the Company s earning assets, is computed by dividing net interest income by average earning assets. This ratio represents the difference between the average yield returned on average earning assets and the average rate paid for funds used to support those earning assets, including both interest-bearing and noninterest-bearing sources. The Company s net interest margin for 2003 was 3.86%, compared to 4.47% and 4.31% for 2002 and 2001, respectively. The main factors contributing to the decrease in the net interest margin for 2003 were declines in yields on earning assets of 95 basis points with declines in rates paid of only 51 basis points, coupled with a decline in average earning assets of $37.8 million and a decline in average interest bearing liabilities of only $16.0 million, while the net interest margin increased in 2002 as a result of higher net interest income and lower average earning assets.

The interest rate spread measures the difference between the average yield on earning assets and the average rate paid on interest-bearing sources of funds. The interest rate spread eliminates the impact of noninterest-bearing funds and gives a more direct perspective to the effect of market interest rate movements. The net interest spread in 2003 was 3.63%, a decrease of 44 basis points from 2002, primarily as a result of greater decreases in assets yields than rates paid on liabilities. The net interest spread for 2002 increased 35 basis points to 4.07% from the Company s 2001 spread of 3.72% as the cost of interest-bearing sources of funds decreased 157 basis points, but the yield on earning assets decreased only 122 basis points. The Company has continuously seen decreases in both net interest margin and net interest spread during 2003 as it has sought higher quality credits in its loan portfolio which generally results in lower asset yields. Loan volumes have also significantly declined, and without corresponding declines in funding, the Company then reinvests in lower yielding investment securities. See the tables in this section below entitled Consolidated Average Balances, Interest Income/Expenses and Yields/Rates and Rate/Volume Variance Analysis for more information.

The following tabulation presents certain net interest income data without modification for assumed tax equivalency:

	Years ended December 31,				
	2003	**2002**	**2001**	**2000**	**1999**
Rate earned on earning assets	**6.78%**	7.73%	8.95%	9.71%	9.40%
Rate paid on borrowed funds	**3.15**	3.66	5.23	5.71	5.00

Interest rate spread.	**3.63**	4.07	3.72	4.00	4.40
Net interest margin	**3.86**	4.47	4.31	4.45	4.86

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At December 31, 2003, the prime interest rate was 4.0%. During 2003, the banking industry saw the prime interest rate decrease 25 basis points in June. During 2002, the banking industry saw the prime interest rate move from 4.75% to 4.25%. This decrease resulted as the prime interest rate fell by 50 basis points in November 2002. This is in contrast to the 450 basis point increase during 2001.

The Consolidated Average Balances, Interest Income/Expenses and Yields/Rates and the Rate/Volume Variance Analysis tables are presented on the following four pages. The Consolidated Average Balances/Interest Income/Expenses and Yields/Rates table presents, for the periods shown, the average balance of certain balance sheet items, the dollar amount of interest income from average earning assets and resultant yields, the interest expense and rate paid on average interest-bearing liabilities, and the net-interest margin. The Rate/Volume Variance Analysis table presents an analysis of changes in interest income, interest expense and net interest income attributable to changes in volume and interest rate.

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CONSOLIDATED AVERAGE BALANCES, INTEREST INCOME/EXPENSE AND YIELDS/RATES

	Years ended December 31,								
	2003			2002			2001		
	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
	(Dollars in thousands)								
Assets (3)									
Earning assets:									
Loans, (1)(2)	**$ 330,941**	**$ 27,468**	**8.30%**	$ 382,126	$ 33,506	8.77%	$ 398,490	$ 39,938	10.02%
Investment securities:									
Taxable	**123,402**	**4,861**	**3.94**	107,566	6,280	5.84	100,599	6,209	6.17
Tax-exempt	**6,680**	**342**	**5.12**	9,028	456	5.05	13,468	693	5.15
Total investment securities	**130,082**	**5,203**	**4.00**	116,594	6,736	5.78	114,067	6,902	6.05
Other interest bearing assets	**3,252**	**198**	**6.09**	2,899	29	1.00	344	44	12.79
Federal funds sold	**23,952**	**255**	**1.06**	24,406	386	1.58	17,816	603	3.38
Total earning assets	**488,227**	**33,124**	**6.78**	526,025	40,657	7.73	530,717	47,487	8.95
Noninterest-bearing assets:									
Cash and due from banks	**28,315**			20,927			21,160		
Premises and equipment	**24,456**			34,133			31,433		
Accrued interest and other assets.	**26,544**			13,315			15,563		
Allowance for loan losses.	**(10,951)**			(7,511)			(5,328)		
Average balances associated with discontinued operations				42,592			131,916		
Total assets	**$ 556,591**			$ 629,481			$ 725,461		
Liabilities and stockholders equity (3)									
Interest-bearing liabilities:									
Demand deposits	**$ 86,053**	**1,391**	**1.62**	$ 79,386	1,725	2.17	$ 73,301	3,237	4.42
Savings deposits	**63,464**	**930**	**1.47**	56,606	1,154	2.04	48,884	2,023	4.14
Time deposits	**247,417**	**8,017**	**3.24**	274,552	10,474	3.81	283,571	15,227	5.37
	396,934	**10,338**	**2.60**	410,544	13,353	3.25	405,756	20,487	5.05
Short-term borrowings	**365**	**3**	**.82**	2,126	36	1.69	3,367	37	1.10
FHLB long-term debt	**38,000**	**2,285**	**6.01**	38,000	2,266	5.96	41,967	2,468	5.88
Capitalized lease obligations	**4,020**	**166**	**4.13**	4,096	225	5.49	4,746	288	6.07
Other long-term debt	**13,369**	**1,473**	**11.02**	13,965	1,273	9.12	15,478	1,354	8.75
Total interest-bearing liabilities	**452,688**	**14,265**	**3.15**	468,731	17,153	3.66	471,314	24,634	5.23
Noninterest-bearing liabilities:									
Demand deposits	**55,463**			56,994			57,347		
Accrued interest and other liabilities	**11,456**			6,846			4,363		
Stockholders equity	**36,984**			42,848			42,938		

Average balances associated with discontinued operations				54,062			149,499		
Total liabilities and stockholders equity	**$ 556,591**			$ 629,481			$ 725,461		
Net interest income/net interest spread		**18,859**	**3.63%**		23,504	4.07%		22,853	3.72%
Net interest margin			**3.86%**			4.47%			4.31%

(1) Average loans include nonaccrual loans. All loans and deposits are domestic.
(2) Income on loans, net of unearned income, includes loan fees.
(3) All yields are computed on income/expense and average balances from continuing operations.

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RATE/VOLUME VARIANCE ANALYSIS

	Average Volume			Change in Volume		Average Rate		
	2003	2002	2001	2003-2002	2002-2001	2003	2002	2001
	(Dollars in thousands)							
Earning Assets:								
Loans	**$ 330,941**	$ 382,126	$ 398,490	**$ (51,185)**	$ (16,364)	**8.30%**	8.77%	10.02%
Investment securities:								
Taxable	**123,402**	107,566	100,599	**15,836**	6,967	**3.94**	5.84	6.17
Tax-exempt	**6,680**	9,028	13,468	**(2,348)**	(4,440)	**5.12**	5.05	5.15
Total investment securities	**130,082**	116,594	114,067	**13,488**	2,527	**4.00**	5.78	6.05
Other interest-bearing assets	**3,252**	2,899	344	**353**	2,555	**6.09**	1.00	12.79
Federal funds sold	**23,952**	24,406	17,816	**(454)**	6,590	**1.06**	1.58	3.38
Total earning assets	**$ 488,227**	$ 526,025	$ 530,717	**$ (37,798)**	$ (4,692)	**6.78**	7.73	8.95
Interest-bearing Liabilities:								
Deposits:								
Demand	**$ 86,053**	$ 79,386	$ 73,301	**$ 6,667**	$ 6,085	**1.62**	2.17	4.42
Savings	**63,464**	56,606	48,884	**6,858**	7,722	**1.47**	2.04	4.14
Time	**247,417**	274,552	283,571	**(27,135)**	(9,019)	**3.24**	3.81	5.37
Total interest-bearing deposits	**396,934**	410,544	405,756	**(13,610)**	4,788	**2.60**	3.25	5.05
Short-term borrowings	**365**	2,126	3,367	**(1,761)**	(1,241)	**0.82**	1.69	1.10
FHLB long-term debt	**38,000**	38,000	41,967		(3,967)	**6.01**	5.96	5.88
Capitalized lease obligations	**4,020**	4,096	4,746	**(76)**	(650)	**4.13**	5.49	6.07
Other long-term debt	**13,369**	13,965	15,478	**(596)**	(1,513)	**11.02**	9.12	8.75
Total interest-bearing liabilities	**$ 452,688**	$ 468,731	$ 471,314	**$ (16,043)**	$ (2,583)	**3.15**	3.66	5.23
Net interest spread.						**3.63%**	4.07%	3.72%
Net interest margin						**3.86%**	4.47%	4.31%

	Interest Income/Expense			Variance		Variance Attributed to (1)			
						2003		2002	
	2003	2002	2001	2003-2002	2002-2001	Volume	Rate	Volume	Rate
	(Dollars in thousands)								
Earning Assets:									
Loans	**$ 27,468**	$ 33,506	$ 39,938	**$ (6,038)**	$ (6,432)	**$ (4,313)**	**$ (1,725)**	$ (1,593)	$ (4,839)

Investment securities:									
Taxable	**4,861**	6,280	6,209	**(1,419)**	71	**831**	**(2,250)**	415	(344)
Tax-exempt	**342**	456	693	**(114)**	(237)	**(120)**	**6**	(224)	(13)
Total investment securities	**5,203**	6,736	6,902	**(1,533)**	(166)	**711**	**(2,244)**	191	(357)
Other interest-bearing assets	**198**	29	44	**169**	(15)	**4**	**165**	59	(74)
Federal funds sold	**255**	386	603	**(131)**	(217)	**(7)**	**(124)**	174	(391)
Total earning assets	**$ 33,124**	$ 40,657	$ 47,487	**$ (7,533)**	$ (6,830)	**$ (3,605)**	**$ (3,928)**	$ (1,169)	$ (5,661)
Interest-bearing Liabilities:									
Deposits:									
Demand	**$ 1,391**	$ 1,725	$ 3,237	**$ (334)**	$ (1,512)	**$ 134**	**$ (468)**	$ 250	$ (1,762)
Savings	**930**	1,154	2,023	**(224)**	(869)	**127**	**(351)**	281	(1,150)
Time	**8,017**	10,474	15,227	**(2,457)**	(4,753)	**(977)**	**(1,480)**	(469)	(4,284)
Total interest-bearing deposits	**10,338**	13,353	20,487	**(3,015)**	(7,134)	**(716)**	**(2,299)**	62	(7,196)
Short-term borrowings	**3**	36	37	**(33)**	(1)	**(20)**	**(13)**	(17)	16
FHLB long-term debt	**2,285**	2,266	2,468	**19**	(202)				