COMMUNITY BANKSHARES INC /SC/
Form 10-Q
May 14, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2004   Commission File No. 000-22054

COMMUNITY BANKSHARES, INC.

(Exact name of registrant as specified in its charter)

South Carolina	57-0966962
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

791 Broughton Street
Orangeburg, South Carolina 29115

(Address of principal executive offices, zip code)

(803) 535-1060

(Registrant's telephone number, including area code)

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 whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, no par or stated value, 4,349,775 shares outstanding on April 29, 2004.

COMMUNITY BANKSHARES, INC.

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PART I - FINANCIAL INFORMATION

Item 1. - Financial Statements

COMMUNITY BANKSHARES, INC.
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Less, allowance for loan losses

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Interest bearing

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Common stock - no par value; 12,000,000 shares authorized; issued and outstanding - 4,336,112 for 2004 and 4,331,460 for 2003

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Total shareholders' equity

Total liabilities and shareholders' equity

See accompanying notes to unaudited consolidated financial statements.

COMMUNITY BANKSHARES, INC.

Consolidated Statement of Income

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Per share	
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Cash dividends declared	

See accompanying notes to unaudited consolidated financial statements.

COMMUNITY BANKSHARES, INC.

Consolidated Statement of Changes in Shareholders' Equity

(Unaudited)

	Common Stock		
	Number of Shares	Amount	Retai Earni
	(Dollars in thousand		
Balance, January 1, 2003	4,304,384	$ 29,090	$ 14
Comprehensive income:			
Net income	-	-	1
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $30	-	-	
Reclassification adjustment for losses (gains) realized in income, net of income taxes of $16	-	-	
Total other comprehensive income	-	-	
Total comprehensive income	-	-	
Exercise of employee stock options	1,600	17	
Cash dividends declared, $.09 per share	-	-	
Balance, March 31, 2003	4,305,984	$ 29,107	$ 15
Balance, January 1, 2004	4,331,460	$ 29,402	$ 18
Comprehensive income:			
Net income	-	-	1
Unrealized holding gains and losses on available-for-sale securities arising during the period, net of income taxes of $171	-	-	
Reclassification adjustment for losses (gains) realized in income, net of income taxes of $1	-	-	
Total other comprehensive income	-	-	
Total comprehensive income	-	-	
Exercise of employee stock options	4,652	45	
Cash dividends declared, $.10 per share	-	-	
Balance, March 31, 2004	4,336,112	$ 29,447	$ 19

See accompanying notes to unaudited consolidated financial statements.

COMMUNITY BANKSHARES, INC.
Consolidated Statement of Cash Flows

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Adjustments to reconcile net income to net
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Net losses or (gains) on sales of securities ....
Proceeds of sales of loans held for sale ....
Originations of loans held for sale ....
Decrease (increase) in accrued interest receivable ....
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Maturities, calls and paydowns of available-for-sale securities ....
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Cash payments for income taxes ....

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See accompanying notes to unaudited consolidated financial statements.

COMMUNITY BANKSHARES, INC.

Notes to Unaudited Consolidated Financial Statements

Accounting Principles - A summary of significant accounting policies and the audited financial statements for 2003 are included in Community Bankshares, Inc.'s (the "Company" or "CBI") Annual Report on Form 10-K for the year ended December 31, 2003. Certain amounts in the 2003 consolidated financial statements have been reclassified to conform to the current period classification. Such reclassification had no effect on previously reported shareholders' equity or net income.

Management Opinion - The interim financial statements in this report are unaudited. In the opinion of management, all the adjustments necessary to present a fair statement of the results for the interim period have been made. Such adjustments are of a normal and recurring nature. The results of operations for any interim period are not necessarily indicative of the results to be expected for an entire year. These interim financial statements should be read in conjunction with the annual financial statements and notes thereto contained in the 2003 Annual Report on Form 10-K.

Nonperforming Loans - As of March 31, 2004, there were $1,482,000 in nonaccrual loans and loans 90 or more days past due and still accruing interest.

Earnings Per Share - Basic earnings per share is computed by dividing net income applicable to common shares by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing applicable net income by the weighted average number of shares outstanding and any dilutive potential common shares and dilutive stock options. It is assumed that all dilutive stock options are exercised at the beginning of each period and that the proceeds are used to purchase shares of the Company's common stock at the average market price during the period. Net income per share and net income per share, assuming dilution, were computed as follows:

Net income per share, basic	
Numerator - net income	
Denominator	
Weighted average common shares issued and outstanding	
Net income per share, basic	
Net income per share, assuming dilution	
Numerator - net income	
Denominator	
Weighted average common shares issued and outstanding	
Effect of dilutive stock options	
Total shares	
Net income per share, assuming dilution	

Stock Based Compensation - The Company has elected to continue using the methodology of Accounting Principles Board Opinion No. 25 ("APB No. 25"), "Accounting for Stock Issued to Employees," to account for compensation expenses related to stock-based compensation. Options issued under the Company's plans have no intrinsic value at the grant date and no compensation cost is recognized in accordance with APB No. 25. Statement of Financial Accounting Standards No. 123 ("SFAS No. 123"), "Accounting for Stock-Based Compensation," requires entities to provide pro forma disclosures of net income, and earnings per share, as if the fair value based method of accounting promulgated by that standard had been applied. While the Company has adopted the disclosure provisions of SFAS No. 123, as amended, there are no current intentions to adopt the fair value recognition provisions of that statement. Had compensation cost for the Company's stock option plan been determined based on the fair value as of the grant dates for awards under the plans consistent with the method prescribed by

SFAS No. 123, the Company's net income and earnings per share would have been adjusted to the pro forma amounts indicated below:

Net income, as reported	
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of any related tax effects	
Pro forma net income	
Net income per share, basic	
As reported	
Pro forma	
Net income per share, assuming dilution	
As reported	
Pro forma	

Variable Interest Entities - On March 8, 2004, CBI sponsored the creation of a Delaware trust, SCB Capital Trust I (the "Trust"), and is the sole owner of the common securities issued by the Trust. On March 10, 2004, the Trust issued $10,000,000 in floating rate capital securities. The proceeds of this issuance, and the amount of CBI's capital investment, were used to acquire $10,310,000 principal amount of CBI's floating rate junior subordinated deferrable interest debt securities ("Debentures") due April 7, 2034, which securities, and the accrued interest thereon, now constitute the Trust's sole assets. The interest rate associated with the debt securities, and the distribution rate on the common securities of the Trust, was established initially at 3.91% and is adjustable quarterly at 3 month LIBOR plus 280 basis points. The index rate (LIBOR) may not be lower than 1.11%. CBI may defer interest payments on the Debentures for up to twenty consecutive quarters, but not beyond the stated maturity date of the Debentures. In the event that such interest payments are deferred by CBI, the Trust may defer distributions on the common securities. In such an event, CBI would be restricted in its ability to pay dividends on its common stock and perform under other obligations that are not senior to the junior subordinated Debentures.

The Debentures are redeemable at par at the option of CBI, in whole or in part, on any interest payment date on or after April 7, 2009. Prior to that date, the Debentures are redeemable at 105% of par upon the occurrence of certain events that would have a negative effect on the Trust or that would cause it to be required to be registered as an investment company under the Investment Company Act of 1940 or that would cause trust preferred securities not to be eligible to be treated as Tier 1 capital by the Federal Reserve Board. Upon repayment or redemption of the Debentures, the Trust will use the proceeds of the transaction to redeem an equivalent amount of trust preferred securities and trust common securities. The Trust's obligations under the trust preferred securities are unconditionally guaranteed by CBI.

The Company's investment in the Trust is carried at cost in other assets and the debentures are included in long-term debt in the consolidated balance sheet.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements

Statements included in Management's Discussion and Analysis of Financial Condition and Results of Operations which are not historical in nature are intended to be, and are hereby identified as "forward looking statements" for purposes of the safe harbor provided by Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements include statements

other than statements of historical facts concerning plans, objectives, goals, strategies, future events or performance and underlying assumptions. Such forward-looking statements may be identified, without limitation, by the use of the words "anticipates," "believes," "estimates," "expects," "intends," "plans," "predicts," "projects," and similar expressions. The Company's expectations, beliefs, estimates and projections are expressed in good faith and are believed by the Company to have a reasonable basis, including without limitation, management's examination of historical operating trends, data contained in the Company's records and other data available from third parties, but there can be no assurance that management's expectations, beliefs, estimates or projections will result or be achieved or accomplished. The Company cautions readers that forward looking statements, including without limitation, those relating to the Company's recent and continuing expansion, its future business prospects, revenues, working capital, liquidity, capital needs, interest costs, income, and adequacy of the allowance for loan losses, are subject to risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements, due to several important factors herein identified, among others, and other risks and factors identified from time to time in the Company's reports filed with the Securities and Exchange Commission. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Critical Accounting Policies

CBI has adopted various accounting policies, which govern the application of accounting principles generally accepted in the United States of America in the preparation of CBI's financial statements. The significant accounting policies of CBI are described in detail in the notes to CBI's audited consolidated financial statements included in CBI's Annual Report on Form 10-K.

Certain accounting policies involve significant judgments and estimates by management, which have a material impact on the carrying value of certain assets and liabilities. Management considers such accounting policies to be critical accounting policies. The judgments and estimates used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions made by management, actual results could differ from these judgments and estimates, which could have a material impact on the carrying values of assets and liabilities and the results of operations of CBI.

CBI is a holding company for four community banks and a mortgage company and, as a financial institution, believes the allowance for loan losses is a critical accounting policy that requires the most significant judgments and estimates used in preparation of its consolidated financial statements. Refer to the sections "Allowance for Loan Losses" and "Provision for Loan Losses" in the Annual Report on Form 10-K for 2003 for a detailed description of CBI's estimation process and methodology related to the allowance for loan losses.

RESULTS OF OPERATIONS

Earnings Performance

For the quarter ended March 31, 2004, CBI earned consolidated net income of $1,385,000, compared with $1,581,000 for the comparable period of 2003. This represents a decrease of $196,000 or 12.4%. Basic earnings per share were $.32 in the 2004 period, compared with $.37 for the 2003 quarter. Diluted earnings per share were $.31 for the 2004 period and $.36 for the 2003 period.

Operating results for the first quarter of 2004 were adversely affected primarily by lower demand for mortgage loan refinancing and other related activity. Because the current low interest rate environment has lasted for a relatively long period of time, most homeowners who would be inclined to refinance existing mortgage debts probably have already done so. As a result, demand for refinancings has declined markedly from the level of 2003. The current level of mortgage loan activity is believed to reflect more nearly the underlying "base" amount of such activity resulting from normal, ongoing factors and, accordingly, is believed to more indicative of a sustainable level of such activity.

The prime lending rate for the first quarter 2004 averaged 4.00%, compared with 4.25% for the same quarter in 2003, putting continuing pressure on CBI's net interest margin. The average yield on earning assets in 2004 was 5.51%, a 56 basis point decline from the same period of 2003. However, CBI's average rate paid on interest bearing liabilities declined also, from 2.37% for the 2003 period to 1.86% for the 2004 period. As a result, interest rate spread decreased only 5 basis points and net interest margin for 2004 was just 10 basis points lower than in 2003. The Company believes that its reductions in rates paid on deposit accounts are comparable to the practices of other competing financial institutions in its market areas. However, because the rates offered for such deposit instruments have declined to such low levels, the ability to effect further cost reductions in this area is believed to be limited.

	Summary Income St		
	(Dollars in thou		
For the Three Months Ended March 31,	2004	2003	D
Interest income	$5,908	$6,100	
Interest expense	1,640	2,001	
Net interest income	4,268	4,099	
Provision for loan losses	233	264	
Noninterest income	1,846	2,304	
Noninterest expenses	3,733	3,735	
Income tax expense	763	823	
Net income	$1,385	$1,581	

Net Interest Income

Net interest income is the amount of interest income earned on interest earning assets (primarily loans, securities, interest bearing deposits in other banks, and federal funds sold), less the interest expense incurred on interest bearing liabilities (interest bearing deposits and other borrowings), and is the principal source of the Company's earnings. Net interest income is affected by the level of interest rates, volume and mix of interest earning assets and interest bearing liabilities and the relative funding of those assets.

Interest income decreased by $192,000, or 3.1%, in the 2004 quarter compared with the same 2003 period. Interest income from mortgage activities declined from $251,000 in the 2003 period to $110,000 for 2004, primarily as a result of the decreased level of activity discussed above. Interest on other lending activities declined from $5,275,000 in the 2003 period to $5,221,000 in the 2004 period due to the lower interest rate environment. Amounts of interest earned on other categories of interest earning assets were substantially unchanged, in the aggregate, as reductions in the average yields earned on those assets were offset by increased average balances held. However, an increase of $22,000 in income from taxable securities was offset by a $20,000 reduction in income from tax-exempt securities.

Interest expense for deposits decreased from $1,546,000 for the 2003 period to $1,232,000 for the 2004 period primarily due to a 62 basis point reduction in the rate paid for time deposits and a 37 basis point decline in the rate paid for savings deposits. Offsetting the effects of these rate reductions were sizable increases in the average amounts of interest bearing transaction and savings accounts. In addition, because of the lower demand for mortgage loan-related products, the Company's average amounts of short-term borrowings declined from $29,832,000 in the 2003 period to $16,767,000 for the 2004 period. As a result, the interest expense for such borrowings declined from $181,000 in 2003 to $105,000 for 2004.

During the first quarter of 2004, CBI sponsored the creation of a Trust that issued $10,000,000 in trust preferred securities. The Trust invested the proceeds of this issuance and $310,000 of capital provided by CBI into $10,310,000 of junior subordinated debentures ("Debentures") issued by CBI. Interest payments on the Debentures are due quarterly at a variable interest rate. CBI used the proceeds of the Debentures to repay certain pre-existing debt obligations, to enhance the capital position of two of the subsidiary banks, to provide an additional funding mechanism for its mortgage brokerage activities, and for other general corporate purposes. Although the interest rate associated with the debt is variable, management believes that the indenture provisions governing that variability will result in less volatility in interest expense than achievable under certain short-term debt agreements. In addition, because of the long-term nature of the new arrangement, transaction costs, such as those incurred to renew lines of credit, are expected to be reduced. Furthermore, under current regulatory guidelines, the trust preferred securities issued by the Trust are includible in Tier 1 capital for risk-based capital purposes.

Average Balances,
Three Months E

2004

Interest

	Average Balances	Income/ Expense	Yields/ Rates*
			(Dollars i
Assets			
Interest earning deposits	$ 1,110	$ 4	1.46%
Investment securities - taxable	57,236	431	3.05%
Investment securities - tax exempt	10,208	84	3.34%
Federal funds sold	24,647	58	0.95%
Loans, including loans held for sale	341,982	5,331	6.32%
Total interest earning assets	435,183	5,908	5.51%
Cash and due from banks	17,314		
Allowance for loan losses	(4,162)		
Premises and equipment	7,073		
Intangible assets	7,618		
Other assets	3,860		
Total assets	$ 466,886		
Liabilities and shareholders' equity			
Interest bearing deposits			
Interest bearing transaction accounts	$ 57,474	$ 66	0.47%
Savings	79,663	183	0.93%
Time deposits	181,616	983	2.20%
Total interest bearing deposits	318,753	1,232	1.57%
Short-term borrowings	16,767	105	2.54%
Long-term debt	22,718	303	5.41%
Total interest bearing liabilities	358,238	1,640	1.86%
Noninterest bearing demand deposits	58,045		
Other liabilities	1,836		
Shareholders' equity	48,767		
Total liabilities and shareholders' equity	$ 466,886		
Interest rate spread			3.65%
Net interest income and net yield on earning assets		$ 4,268	3.98%
Interest free funds supporting earning assets	$ 76,945		

* Yields and rates are annualized.

Provision and Allowance for Loan Losses

The provision for loan losses for the 2004 period was $233,000, a decrease of $31,000, or 11.7%, from the $264,000 for the same period of 2003. During the first quarter of 2004, a nonaccrual loan in the amount of $1,350,000, or approximately 52% of CBI's December 31, 2003 nonaccrual loans, was satisfactorily resolved with CBI collecting all principal and interest owed. Because of this favorable outcome, the amount previously included in the allowance for loan losses for this loan was no longer required. Therefore, the 2004 provision for loan losses was beneficially affected.

Net charge-offs during the three months ended March 31, 2004 were $234,000, compared with $70,000 for the same period of 2003. The allowance for loan losses as of March 31, 2004 was 1.24% of loans outstanding, compared with 1.27% as of December 31, 2003 and 1.20% as of March 31, 2003. Non-performing loans totaled $1,482,000 as of March 31, 2004, compared with $2,741,000 as of December 31, 2003, a decrease of $1,259,000 or 45.9%. The coverage ratio (allowance for loan losses divided by non-performing loans) was 2.84x as of March 31, 2004 and 1.53x as of December 31, 2003. The majority of non-performing loans at March 31, 2004 were secured by commercial real estate and other collateral.

Management believes that the allowance for loan losses, as of March 31, 2004, is adequate to absorb the losses inherent in the loan portfolio. Management will continue to monitor the levels of non-performing and potential problem loans and address the weaknesses in these credits to enhance the ultimate collection or recovery of these assets. Management considers the levels and trends in non-performing assets and past due loans in determining how the provision and allowance for loan losses is estimated and adjusted.

The activity in the allowance for loan losses is summarized in the following table:

	Three Months Ended March 31, 2004	Year Decembe
		(Dollars
Allowance at beginning of period	$ 4,206	$
Provision for loan losses	233	
Net charge-offs	(234)	
Allowance at end of period	$ 4,205	$
Allowance as a percentage of loans outstanding	1.24%	
Loans at end of period	$ 338,945	$

Following is a summary of non-performing loans as of March 31, 2004 and December 31, 2003:

	March 31, 2004	December 31, 2003
	(Dollars in thousands)	
Non-performing loans		
Nonaccrual loans	$1,162	$2,595
Past due 90 days or more and still accruing	320	146
Total	$1,482	$2,741
Nonperforming loans as a percentage of loans outstanding	0.44%	0.83%

Noninterest Income

Non-interest income for the 2004 period decreased $458,000, or 19.9%, from the $2,304,000 reported for the 2003 period. Mortgage brokerage income decreased $511,000, or 40.6%, from $1,260,000 in the 2003 period to $749,000 for the 2004 period, due to the market factors discussed previously. Service charge income continued to improve, totaling $845,000 in the 2004 period, an increase of $62,000, or 7.9%, due to the continued success of the Automatic Overdraft Protection product.

Noninterest Expenses

Salaries and employee benefits for the 2004 period were $240,000, or 10.2%, less than for the same period of 2003. This decrease resulted primarily from the decreased level of activity in the mortgage brokerage subsidiary. Because demand for refinancing and other mortgage loan products has declined recently, the number of employees needed to conduct the operations of that company has decreased. Also, that entity's compensation system is predominantly commission-based. Expenses associated with premises and equipment were $88,000, or 21.8%, higher in the 2004 period, primarily due to the acquisition and implementation of hardware and software associated with imaging technologies. Over time, the use of such technology is expected to reduce postage expense, reduce time required for research, improve internal processes and access to information, enable the Company to take advantage of the opportunities presented by the recent Check 21 legislation, and enhance the Company's ability to provide service to its customers. Other expenses were $150,000, or 15.3%, higher in the 2004 period. The major area of increase was advertising, which was increased primarily as a result of the mortgage company's efforts to increase sales.

Income Taxes

Although income tax expense for 2004 decreased $60,000, or 7.3%, from the amount for 2003, the average tax rate for 2004 was 35.5% while in 2003 it was 34.2%. The increase in the average tax rate for 2004 is a result of a lower percentage of income being derived from tax-exempt sources in the current period. While average interest earning assets for the 2004 period were $27,348,000, or 6.7%, more than in the 2003 period, tax-exempt investments increased only $674,000, or 7.1%, and the yield on such securities decreased by 108 basis points, or 24.4%. As a result of these factors, interest income derived from tax-exempt investment securities was $20,000 less in 2004 than in 2003 and was 3.9% of pretax income in the 2004 period, compared with 4.3% in the 2003 period.

LIQUIDITY

Liquidity is the ability to meet current and future obligations through liquidation or maturity of existing assets or the acquisition of additional liabilities. Adequate liquidity is necessary to meet the requirements of customers for loans and deposit withdrawals in a timely and economical manner. The most manageable sources of liquidity are composed of liabilities, with the primary focus of liquidity management being the ability to attract deposits within CBI's service areas. Individual and commercial deposits are the primary source of funds for credit activities, along with long-term borrowings from the Federal Home Loan Bank of Atlanta and the net proceeds of issuing $10,000,000 of trust preferred securities. Cash and amounts due from banks and federal funds sold are CBI's primary sources of asset liquidity. These funds provide a cushion against short-term fluctuation in cash flow from both loans and deposits. Securities available-for-sale are CBI's principal source of secondary asset liquidity. However, the availability of this source is limited by pledging commitments for public deposits and securities sold under agreements to repurchase, and is influenced by market conditions.

Total deposits as of March 31, 2003 were $367,605,000, a decrease of $11,099,000, or 2.9%, from the amount as of December 31, 2003, primarily as a result of fluctuations in the amounts of public deposits held by the banking subsidiaries. As of March 31, 2003 the loan to deposit ratio was 92.2%, compared with 87.7% at December 31, 2003 and 90.5% at March 31, 2003.

Management believes CBI and its subsidiaries' liquidity sources are adequate to meet their current and projected operating needs.

CAPITAL RESOURCES

CBI and its banking subsidiaries are subject to regulatory risk-based capital adequacy standards. Under these standards, bank holding companies and banks are required to maintain certain minimum ratios of capital to risk-weighted assets and average total assets. Under the provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991, federal bank regulatory authorities are required to implement prescribed "prompt corrective actions" upon the deterioration of the capital position of a bank. If the capital position of an affected institution were to fall below a certain level, increasingly stringent regulatory corrective actions would be mandated.

The March 31, 2004 risk-based capital ratios for CBI and its banking subsidiaries are presented in the following table, compared with the "well capitalized" and minimum ratios under the regulatory definitions and guidelines:

		March 31, 2004	
	Tier 1	Total Capital	Leverage
Community Bankshares, Inc.	15.25%	16.39%	11.19%
Orangeburg National Bank	13.05%	14.30%	8.90%
Sumter National Bank	10.91%	12.12%	9.53%
Florence National Bank	12.14%	13.25%	10.47%
Bank of Ridgeway	14.05%	14.94%	8.43%
Minimum "well capitalized" requirement	6.00%	10.00%	6.00%
Minimum requirement	4.00%	8.00%	4.00%

As shown in the table above, each of the capital ratios exceeds the regulatory requirement to be considered "well capitalized." In the opinion of management, the current and projected capital positions of CBI and its banking subsidiaries are adequate.

OFF-BALANCE-SHEET ARRANGEMENTS

In the normal course of business, CBI engages in transactions that, in accordance with generally accepted accounting principles, are not recorded in the financial statements (generally commitments to extend credit) or are recorded in amounts that differ from their notional amounts (generally derivatives). These transactions involve elements of credit, interest rate and liquidity risk of varying degrees. Such transactions are used by CBI for general corporate purposes.

Variable Interest Entity

As discussd under "Results of Operations - Net Interest Income" and in the notes to unaudited consolidated financial statements under "Variable Interest Entities," as of March 31, 2004, CBI held an equity interest in, and guarantees the liabilities of, a non-consolidated variable interest entity.

Commitments

CBI's banking and mortgage brokerage subsidiaries are parties to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of their customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve varying degrees of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. Exposure to credit loss is represented by the contractual, or notional, amounts of these commitments. The same credit policies are used in making commitments as for on-balance-sheet instruments.

The following table sets forth the contractual amounts of commitments which represent credit risk:

	March 31, 2004 (Dollars in thousands)
Loan commitments	$ 44,776
Standby letters of credit	2,730

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if deemed necessary by management upon extension of credit, is based on management's credit evaluation of the counter-party. Collateral held varies but may include personal residences, accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support private borrowing arrangements. All letters of credit are short-term guarantees. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Generally, collateral supporting those commitments is held if deemed necessary. Since many of the standby letters of credit are expected to expire without being drawn upon, the total letter of credit amounts do not necessarily represent future cash requirements.

Derivative Financial Instruments

In April, 2003, the Financial Accounting Standards Board issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." Among other requirements, this Statement provides that loan commitment contracts entered into or modified after June 30, 2003 that relate to the origination of mortgage loans that will be held for sale shall be accounted for as derivative instruments by the issuer of the loan commitment. CBI issues mortgage loan rate lock commitments to potential borrowers to facilitate its origination of home mortgage loans that are intended to be sold. Between the time that CBI issues its commitments and the time that the loans close and are sold, CBI is subject to variability in the selling prices related to those commitments due to changes in market rates of interest. However, CBI offsets this variability through the use of so-called "forward sales contracts" to investors in the secondary market. Under these arrangements, an investor agrees to purchase the closed loans at a predetermined price. CBI generally enters into such forward sales contracts at the same time that rate lock commitments are issued. These arrangements are designated as fair value hedges. These derivative financial instruments are carried in the balance sheet at estimated fair value and changes in the estimated fair values of these derivatives are recorded in the statement of income in net gains or losses on loans held for sale. Because CBI has effectively matched its forward sales contracts to investors and rate lock commitments to potential borrowers, no net gains or losses due to changes in market interest rates have been recorded in the statement of income.

Derivative financial instruments are written in amounts referred to as notional amounts. Notional amounts only provide the basis for calculating payments between counterparties and do not represent amounts to be exchanged between parties or a measure of financial risk. The following table includes the notional principal amounts of rate lock commitments and forward sales contracts as of March 31, 2004, and the estimated fair values of those financial instruments included in other assets and liabilities in the balance sheet as of that date.

	March 31, 2004	
	Notional Amount	Estimated Fair Value Asset (Liability)
	(Dollars in thousands)	
Rate lock commitments to potential borrowers to originate mortgage loans to be held for sale	$10,765	$ (76)
Forward sales contracts with investors of mortgage loans to be held for sale	10,765	76

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of loss from adverse changes in market prices and rates. CBI's market risk arises principally from interest rate risk inherent in its lending, deposit and borrowing activities. Management actively monitors and manages its interest rate risk exposure. Although CBI manages other risks, such as credit quality and liquidity risk in the normal course of business, management considers interest rate risk to be its most significant market risk and this risk could potentially have the largest material effect on CBI's financial condition and results of operations. Other types of market risks such as foreign currency exchange risk and commodity price risk do not arise in the normal course of community banking activities.

CBI's Asset/Liability Committee uses a simulation model to assist in achieving consistent growth in net interest income while managing interest rate risk. According to the model, as of March 31, 2004, CBI is positioned so that net interest income would increase $383,000 and net income would increase $227,000 in the next twelve months if interest rates rose 100 basis points. Conversely, net interest income would decline $483,000 and net income would decline $297,000 in the next twelve months if interest rates declined 100 basis points. CBI issued $10 million in trust preferred securities that float with LIBOR, which are at or near their contractual floor rate. In the current interest rate environment, it is not expected that there will be any large decreases in market interest rates in the immediate future. Computation of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates and loan prepayment, and should not be relied upon as indicative of actual results. Further, the computations do not contemplate any actions CBI and its customers could undertake in response to changes in interest rates.

As of March 31, 2004 there was no significant change from the interest rate sensitivity analysis for the various changes in interest rates calculated as of December 31, 2003. The foregoing disclosures related to the market risk of CBI should be read in connection with Management's Discussion and Analysis of Financial Position and Results of Operations included in the 2003 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Based on the evaluation required by 17 C.F.R. Section 240.13a-15(b) or 240.15d-15(b) of the Company's disclosure controls and procedures (as defined in 17 C.F.R. Sections 240.13a-15(e) and 240.15d-15(e)), the Company's chief executive officer and chief financial officer concluded that the effectiveness of such controls and procedures, as of the end of the period covered by this quarterly report, was adequate.

No disclosure is required under 17 C.F.R. Section 229.308(c).

PART II--OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

a) Exhibits

10-1 Indenture, dated as of March 10, 2004, between Community Bankshares, Inc. and Wells Fargo Bank, National Association

10-2 Amended and Restated Declaration of Trust, SCB Capital Trust I, dated as of March 10, 2004

10-3 Guranty Agreement, dated as of March 10, 2004

31-1 Rule 13a-14(a)/15d-14(a) Certification of principal executive officer

31-2 Rule 13a-14(a)/15d-14(a) Certification of principal financial officer

32 Certifications Pursuant to 18 U.S.C. Section 1350

b) Reports on Form 8-K. Form 8-K filed January 23, 2004 pursuant to Items 7 and 12 of that Form.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DATED: May 12, 2004

COMMUNITY BANKSHARES, INC.

By: s/ E. J. Ayers, Jr.,

E. J. Ayers, Jr.,
Chief Executive Officer

By: s/ William W. Traynham

William W. Traynham
President and Chief Financial Officer
(Principal Accounting Officer)

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