CNB CORPORATION

2015
ANNUAL REPORT

303 North Main Street • Cheboygan, Michigan 49721 • Phone 231-627-7111

CNB CORPORATION
ANNUAL REPORT
December 31, 2015 and 2014

CONTENTS

CNB CORPORATION
ANNUAL SHAREHOLDERS' MEETING

Tuesday, May 17, 2016, 5:30 p.m. • Knights of Columbus Hall
Cheboygan, Michigan

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Independent Auditor's Report

To the Board of Directors
CNB Corporation

Report on the Consolidated Financial Statements

We have audited the consolidated financial statements of CNB Corporation and its subsidiary (collectively, the "Company"), which comprise the consolidated balance sheet as of December 31, 2015 and 2014 and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CNB Corporation and its subsidiary as of December 31, 2015 and 2014 and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Plante & Moran, PLLC

March 17, 2016

CNB Corporation

Consolidated Balance Sheet

(000s omitted, except per share data)

		December 31, 2015		December 31, 2014
Assets				
Cash and due from banks	$	5,952	$	6,573
Interest-bearing deposits with other financial institutions		25,617		6,241
Total cash and cash equivalents		31,569		12,814
Time deposits with other financial institutions		8,711		7,547
Investment securities - Available for sale (Note 2)		86,690		93,106
Investment securities - Held to maturity (Note 2)		4,835		6,529
Other securities		905		972
Loans held for sale		369		295
Loans - Net of allowance for loan losses of $1,509 and $1,726 (Note 3)		122,936		117,591
Premises and equipment (Note 5)		5,518		4,999
Other assets (Notes 4, 6, 8, and 9)		10,127		10,068
Total assets	**$**	**271,660**	**$**	**253,921**
Liabilities and Stockholders' Equity				
Liabilities				
Deposits (Note 7):				
Noninterest-bearing	$	63,131	$	51,169
Interest-bearing		180,041		175,806
Total deposits		243,172		226,975
Accrued and other liabilities (Note 8)		4,541		4,208
Total liabilities		247,713		231,183
Stockholders' Equity				
Common stock - $2.50 par value; 2,000,000 shares authorized; 1,212,098 shares issued and outstanding in 2015 and 2014		3,030		3,030
Additional paid-in capital		19,499		19,499
Retained earnings		3,197		1,691
Accumulated other comprehensive loss - Net of tax		(1,779)		(1,482)
Total stockholders' equity		23,947		22,738
Total liabilities and stockholders' equity	**$**	**271,660**	**$**	**253,921**

See Notes to Consolidated Financial Statements.

CNB Corporation

Consolidated Statement of Income

(000s omitted, except per share data)

	Year Ended December 31, 2015	Year Ended December 31, 2014
Interest Income		
Loans - Including fees	$ 6,205	$ 6,847
Debt securities:		
Taxable	1,327	1,159
Tax exempt	220	236
Other	125	122
Total interest income	7,877	8,364
Interest Expense	307	384
Net Interest Income	7,570	7,980
Recapture of Loan Losses (Note 3)	(300)	(900)
Net Interest Income After Recapture of Loan Losses	7,870	8,880
Noninterest Income		
Service charges and fees	1,000	947
Net gain on sale of loans and mortgage banking income	579	246
Net gain on sale of securities	12	365
Securities impairment recovery	54	57
Loan servicing fees - Net of amortization	171	158
Gain on the sale of other real estate owned	67	204
Other	338	341
Total noninterest income	2,221	2,318
Noninterest Expense		
Salaries and employee benefits	4,076	3,752
Occupancy and equipment	878	1,046
System conversion costs	-	476
FDIC premiums	149	238
Deferred compensation	188	194
Pension	162	100
Hospitalization	542	496
Legal and professional	535	635
Other	1,499	1,583
Total noninterest expense	8,029	8,520
Income - Before income taxes	2,062	2,678
Income Tax Expense	374	787
Net Income	**$ 1,688**	**$ 1,891**
Earnings per Share		
Basic	**$ 1.39**	**$ 1.56**
Diluted	**$ 1.39**	**$ 1.56**

CNB Corporation

Consolidated Statement of Comprehensive Income

(000s omitted, except per share data)

	Year Ended December 31, 2015	Year Ended December 31, 2014
Net Income	$ 1,688	$ 1,891
Other Comprehensive (Loss) Income		
Unrealized (loss) gain on securities:		
(Loss) gain arising during the year	(192)	1,410
Reclassification adjustment for gains recognized on securities sold	(66)	(422)
Total unrealized (loss) gain on securities	(258)	988
Defined benefit pension:		
Net loss during the period	(195)	(400)
Prior service cost recognized during period	4	4
Total defined benefit pension	(191)	(396)
Tax effects	152	(201)
Total other comprehensive (loss) income	(297)	391
Comprehensive Income	**$ 1,391**	**$ 2,282**

Consolidated Statement of Changes in Stockholders' Equity

(000s omitted, except per share data)

	Shares of Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
Balance - January 1, 2014	1,212,098	$ 3,030	$ 19,499	$ 164	$ (1,873)	$ 20,820
Net income	-	-	-	1,891	-	1,891
Other comprehensive income	-	-	-	-	391	391
Dividends declared $0.30 per share	-	-	-	(364)	-	(364)
Balance - December 31, 2014	1,212,098	3,030	19,499	1,691	(1,482)	22,738
Net income	-	-	-	1,688	-	1,688
Other comprehensive loss	-	-	-	-	(297)	(297)
Dividends declared $0.15 per share	-	-	-	(182)	-	(182)
Balance - December 31, 2015	**1,212,098**	**$ 3,030**	**$ 19,499**	**$ 3,197**	**$ (1,779)**	**$ 23,947**

See Notes to Consolidated Financial Statements.

Consolidated Statement of Cash Flows
(000s omitted, except per share data)

	Year Ended December 31 2015	2014
Cash Flows from Operating Activities		
Net income	$ 1,688	$ 1,891
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	695	728
Provision for loan losses	(300)	(900)
Loans originated for sale	(16,372)	(9,546)
Proceeds from sales of loans originated for sale	16,812	9,730
Gain on sales of investment securities	(66)	(422)
Gain on sale of loans	(514)	(183)
Gain on sales of other real estate owned properties	(67)	(204)
Other real estate owned writedowns	70	15
Increase in cash surrender value of life insurance	(159)	(146)
Deferred tax expense	374	757
Decrease in other assets	(672)	1,250
Increase in other liabilities	334	107
Net cash provided by operating activities	1,823	3,077
Cash Flows from Investing Activities		
Proceeds from sales of securities available for sale	823	2,433
Proceeds from maturities of securities available for sale	32,496	16,124
Purchase of securities available for sale	(27,195)	(27,239)
Proceeds from maturities of securities held to maturity	5,529	1,821
Purchase of securities held to maturity	(3,835)	(2,625)
Proceeds from maturities of time deposits	-	3,622
Purchase of time deposits	(1,164)	-
Net change in portfolio loans	(5,405)	2,275
Redemption of other securities	67	25
Premises and equipment expenditures	(847)	(248)
Proceeds from sales and redemptions of other real estate owned properties	449	655
Purchase of bank owned life insurance policies	-	(1,000)
Net cash provided by (used in) investing activities	918	(4,157)
Cash Flows from Financing Activities		
Net increase in deposit accounts	16,196	4,162
Dividends paid	(182)	(364)
Net cash provided by financing activities	16,014	3,798
Net Increase in Cash and Cash Equivalents	18,755	2,718
Cash and Cash Equivalents - Beginning of year	12,814	10,096
Cash and Cash Equivalents - End of year	**$ 31,569**	**$ 12,814**
Supplemental Cash Flow Information		
Cash paid for:		
Interest	$ 310	$ 385
Income taxes	-	30
Transfer from loans to other real estate owned	360	113

Note 1 - Nature of Business and Significant Accounting Policies

Principles of Consolidation - The consolidated financial statements include CNB Corporation (the "Company") and its wholly owned subsidiary, Citizens National Bank of Cheboygan (the "Bank"). All significant intercompany accounts and transactions are eliminated in consolidation.

Nature of Operations and Concentrations of Credit Risk - The Company is a one-bank holding company which conducts no direct business activities. All business activities are performed by the Bank.

The Bank provides a full range of banking services to individuals, agricultural businesses, commercial businesses, and light industries located in its service area. It maintains a diversified loan portfolio, including loans to individuals for home mortgages, automobiles, personal expenditures, and loans to business enterprises for current operations and expansion. The Bank offers a variety of deposit accounts, including checking, savings, money market, and individual retirement accounts and certificates of deposit.

The principal markets for the Bank's financial services are the Michigan communities in which the Bank is located and the area immediately surrounding these communities. The Bank serves these markets through seven offices located in Cheboygan, Presque Isle, and Emmet Counties and a loan production office in Otsego County in northern lower Michigan.

Use of Estimates - To prepare consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of investment securities, and the pension obligation.

Cash and Cash Equivalents - Cash and cash equivalents include cash and due from banks, interest-bearing deposits with other financial institutions, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions.

Securities - Securities are classified as "held to maturity" when management has the positive intent and ability to hold them to maturity and carried at amortized cost. Securities classified as "available for sale" are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Other securities, which include Federal Reserve Bank stock and Federal Home Loan Bank stock, are carried at cost.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities whereby prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Loans - Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at the principal balance outstanding, net of deferred loan fees and costs, and an allowance for loan losses. Loans held for sale are reported at the lower of cost or market on an aggregate basis.

Troubled debt restructuring of loans is undertaken to improve the likelihood that the loan will be repaid in full under the modified terms in accordance with a reasonable repayment schedule. All modified loans are evaluated to determine whether the loans should be reported as a troubled debt restructure (TDR). A loan is a TDR when the Company, for economic or legal reasons related to the borrower's financial difficulties, grants a concession to the borrower by modifying or renewing a loan that the Company would not otherwise consider. To make this determination, the Company must determine whether (a) the borrower is experiencing financial difficulties and (b) the Company granted the borrower a concession. This determination requires consideration of all of the facts and circumstances surrounding the modification. An overall general decline in the economy or some deterioration in a borrower's financial condition does not automatically mean the borrower is experiencing financial difficulties.

Loan Income - Interest income is earned on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Interest income is not reported when full loan repayment is in doubt, typically when the loan is impaired or payments are past due over 90 days (180 days for residential mortgages).

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

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

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

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired or loans otherwise classified as substandard or doubtful. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors.

A loan is impaired when full payment under the loan terms is not expected. Impairment is evaluated in total for smaller balance homogenous loans of similar nature, such as residential mortgage, consumer, and credit card loans, and on an individual loan basis for other loans. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Premises and Equipment - Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the assets' useful lives. For furniture and fixtures the useful life ranges from three to seven years while the useful life for buildings is 39 years. These assets are reviewed for impairment when events indicate the carrying amount may not be recoverable. Maintenance and repairs are charged to expense and improvements are capitalized.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Other Real Estate Owned - Real estate properties acquired through, or in lieu of, loan foreclosure are initially recorded at the lower of the loan carrying amount or fair value at acquisition. Any reduction to fair value from the carrying value of the related loan is accounted for as a loan loss. After acquisition, a valuation allowance reduces the reported amount to the lower of the initial amount or fair value less costs to sell. Expenses, gains and losses on disposition, and changes in the valuation allowance are reported as expenses on the consolidated statement of operations.

Servicing Rights - Servicing rights represent the allocated value of servicing rights retained on loans sold. Servicing rights are expensed in proportion to, and over the period of, estimated net servicing revenue. Impairment is evaluated based on the fair value of the rights, using groupings of the underlying loans as to interest rates and then, secondarily, as to prepayment characteristics. Any impairment of a grouping is reported as a valuation allowance.

Bank Owned Life Insurance - The Bank has purchased life insurance policies on certain directors and executives. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be effectively realized at the consolidated balance sheet date. At December 31, 2015 and 2014, the cash surrender value of the underlying policies was $5,697,000 and $5,538,000, which is included in other assets on the consolidated balance sheet.

Employee Benefits - A defined benefit pension plan covers substantially all employees, with benefits based on years of service and compensation prior to retirement. Contributions to the plan are based on the maximum amount deductible for income tax purposes. The plan was amended to no longer accept new participants as of December 31, 2008. Current participants will receive benefits as originally outlined in the plan. A 401(k) savings and retirement plan has also been established and covers substantially all employees. Discretionary contributions to the 401(k) plan are expensed as made.

Income Taxes - Income tax expense is the sum of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax consequences of temporary differences between the carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

Financial Instruments with Off-balance-sheet Risk - The Company, in the ordinary course of business, makes commitments to extend credit which are not reflected in the consolidated financial statements. A summary of these commitments is disclosed in Note 11.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Comprehensive Income - Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income includes the net change in unrealized gains (loss) on securities available for sale, and components of the defined benefit pension obligation not yet recognized as components of periodic pension expense, including unrecognized gains or losses, prior service cost, and the unrecognized transition asset. These items are reported in comprehensive income (loss) net of tax. The components of accumulated other comprehensive income (loss) consisted of unrealized (losses) gains on securities and defined benefit pension obligation of approximately ($14,000) and ($1,765,000), respectively, in 2015 and $157,000 and ($1,639,000), respectively, in 2014.

Earnings per Common Share - Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. There were no outstanding stock options as of December 31, 2015 or 2014. Accordingly, no dilutive impact is presented.

Subsequent Events - The consolidated financial statements and related disclosures include evaluation of events up through and including March 17, 2016, which is the date the consolidated financial statements were available to be issued.

Upcoming Accounting Change - In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The ASU adopts a standardized approach for revenue recognition and was a joint effort with the International Accounting Standards Board (IASB). The new revenue recognition standard is based on a core principle of recognizing revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU does not apply to financial instruments. The ASU is effective for annual reporting periods beginning after December 15, 2017 (therefore, for the year ending December 31, 2018 for the Company). Early adoption is permitted only as of annual periods beginning after December 15, 2016. Management is currently assessing the impact to the Company's consolidated financial statements.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

New Accounting Pronouncement - The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The ASU covers various changes to the accounting, measurement, and disclosure related to certain financial instruments. The most significant change included in the update is the requirement for certain equity investments (excluding investments that are consolidated or accounted for under the equity method) to be measured at fair value with changes in fair value recognized in net income. Alternatively, equity investments without readily determinable fair values can be recorded at cost, and periodically evaluated for impairment using a qualitative assessment. If the qualitative assessment indicates the investment is impaired, it is required to be measured at fair value. As of December 31, 2015, the Company does not hold any financial instruments impacted by these changes within ASU No. 2016-01. The update also eliminates the requirement for public business entities to disclose the methods and assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The new standard is effective for the year ending December 31, 2018 for the Company. Management is currently assessing the impact to the Company's consolidated financial statements.

Note 2 - Securities

The year-end fair values and related gross unrealized gains and losses recognized in accumulated other comprehensive loss for securities available for sale were as follows (000s omitted):

	2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Available-for-sale securities:				
U.S. government and agency	$ 32,885	$ 58	$ (49)	$ 32,894
Mortgage-backed	22,306	27	(133)	22,200
Collateralized mortgage obligations	15,010	2	(158)	14,854
State and municipal	16,509	262	(29)	16,742
Total available-for-sale securities	86,710	349	(369)	86,690
Held-to-maturity securities:				
State and municipal	4,835	155	-	4,990
Total available-for-sale and held-to-maturity securities	$ 91,545	$ 504	$ (369)	$ 91,680

Note 2 - Securities (Continued)

	2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Available-for-sale securities:				
U.S. government and agency	$ 34,224	$ 74	$ (28)	$ 34,270
Mortgage-backed	20,522	114	(44)	20,592
Collateralized mortgage obligations	19,463	8	(154)	19,317
State and municipal	18,660	299	(32)	18,927
Total available-for-sale securities	92,869	495	(258)	93,106
Held-to-maturity securities:				
State and municipal	6,529	227	-	6,756
Total available-for-sale and held-to-maturity securities	$ 99,398	$ 722	$ (258)	$ 99,862

During 2015, the Company sold two investments and five additional investments were called. Proceeds from the sales were approximately $823,000, resulting in gains of approximately $6,000. Proceeds from the calls were approximately $11,600,000, resulting in gains of approximately $6,000. During 2014, the Company sold two investments. Proceeds from the sales were $2,433,000, resulting in gains of $422,000. There were no losses recorded from the sales in 2014 or 2015.

Contractual maturities of debt securities at December 31, 2015 are presented below. Expected maturities may differ from contractual maturity because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date, primarily mortgage-backed securities, are presented separately.

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2015 follow (000s omitted):

	Available for Sale		Held to Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 12,081	$ 12,090	$ 3,363	$ 3,370
Due in one through five years	33,785	33,831	1,112	1,203
Due after five years through ten years	3,238	3,364	360	417
Thereafter	290	351	-	-
Mortgage-backed	22,306	22,200	-	-
Collateralized mortgage obligations	15,010	14,854	-	-
Total	$ 86,710	$ 86,690	$ 4,835	$ 4,990

Note 2 - Securities (Continued)

Securities with unrealized losses at December 31, 2015 and 2014, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (000s omitted):

	2015			
	Less than 12 Months		Over 12 Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. government and agency	$ (49)	$ 16,539	$ -	$ -
Mortgage-backed	(85)	16,284	(48)	1,932
Collateralized mortgage obligations	(56)	9,556	(102)	4,265
State and municipal	(29)	6,780	-	-
Total available-for-sale securities	$ (219)	$ 49,159	$ (150)	$ 6,197

	2014			
	Less than 12 Months		Over 12 Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. government and agency	$ (14)	$ 6,401	$ (14)	$ 2,497
Mortgage-backed	(9)	7,285	(35)	1,534
Collateralized mortgage obligations	(22)	8,232	(132)	8,284
State and municipal	(24)	6,311	(8)	1,588
Total available-for-sale securities	$ (69)	$ 28,229	$ (189)	$ 13,903

Unrealized losses remaining on the consolidated balance sheet at December 31, 2015 and 2014 have not been recognized into income because they are not considered to be other than temporary. Management considers the unrealized losses to be market driven, resulting from changes in interest rates, and the Company has the intent and ability to hold the securities until their value recovers.

Note 2 - Securities (Continued)

Management evaluates securities for other-than-temporary impairment (OTTI) on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. When evaluating investment securities, consideration is given to the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, whether the market decline was affected by macroeconomic conditions, and whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, or U.S. government-sponsored enterprises, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

Note 3 - Loans

Year end loans were as follows (000s omitted):

	2015	2014
Residential real estate	$ 55,625	$ 54,984
Consumer	6,431	6,758
Commercial real estate	54,103	51,443
Commercial	8,400	6,263
Total	124,559	119,448
Less:		
Deferred fees	(114)	(131)
Allowance for credit losses	(1,509)	(1,726)
Net loans	$ 122,936	$ 117,591

Note 3 - Loans (Continued)

Activity in the allowance for loan losses for 2015 and 2014 is summarized as follows (000s omitted):

	Year Ended December 31, 2015					
	Residential Real Estate	Consumer	Commercial Real Estate	Commercial	Unallocated	Total
Beginning balance	$ 262	$ 19	$ 995	$ 195	$ 255	$ 1,726
Charge-offs	(59)	(19)	(35)	-	-	(113)
Recoveries	26	11	152	7	-	196
Provision	46	(3)	(557)	54	160	(300)
Ending balance	$ 275	$ 8	$ 555	$ 256	$ 415	$ 1,509
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 167	$ -	$ 320	$ 188	$ -	$ 675
Collectively evaluated for impairment	108	8	235	68	415	834
Ending allowance balance	$ 275	$ 8	$ 555	$ 256	$ 415	$ 1,509
Loans:						
Individually evaluated for impairment	$ 1,591	$ -	$ 4,518	$ 205	$ -	$ 6,314
Collectively evaluated for impairment	54,034	6,431	49,585	8,195	-	118,245
Ending loan balance	$ 55,625	$ 6,431	$ 54,103	$ 8,400	$ -	$ 124,559

	Year Ended December 31, 2014					
	Residential Real Estate	Consumer	Commercial Real Estate	Commercial	Unallocated	Total
Beginning balance	$ 422	$ 4	$ 2,397	$ 64	$ 189	$ 3,076
Charge-offs	(121)	(38)	(452)	-	-	(611)
Recoveries	26	11	122	2	-	161
Provision	(65)	42	(1,072)	129	66	(900)
Ending balance	$ 262	$ 19	$ 995	$ 195	$ 255	$ 1,726
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 110	$ -	$ 446	$ 155	$ -	$ 711
Collectively evaluated for impairment	152	19	549	40	255	1,015
Ending allowance balance	$ 262	$ 19	$ 995	$ 195	$ 255	$ 1,726
Loans:						
Individually evaluated for impairment	$ 1,365	$ -	$ 4,703	$ 238	$ -	$ 6,306
Collectively evaluated for impairment	53,619	6,758	46,740	6,025	-	113,142
Ending loan balance	$ 54,984	$ 6,758	$ 51,443	$ 6,263	$ -	$ 119,448

Credit Risk Grading

The Company evaluates the credit quality of loans in the consumer loan portfolio, based primarily on the aging status of the loan. Accordingly loans past due as to principal or interest 90 days or more are considered in a nonperforming status for the purpose of credit quality evaluation. All consumer loans were performing as of December 31, 2015 and 2014.

Note 3 - Loans (Continued)

The Company evaluates the credit quality of loans in the residential loan portfolio based primarily on the aging status of the loan, payment activity, and credit quality indicators as defined below for commercial loans. The following schedules present the recorded investment of loans in the portfolio by risk rating categories at December 31, 2015 and 2014 (000s omitted):

	December 31, 2015					
	Pass	Special Mention (4)	Substandard (5)	Doubtful (6)	Loss (7)	Total
Residential real estate	$ 54,108	$ -	$ 1,517	$ -	$ -	$ 55,625
Consumer	6,431	-	-	-	-	6,431
Commercial real estate	52,069	87	1,947	-	-	54,103
Commercial	8,213	-	187	-	-	8,400
Total	$ 120,821	$ 87	$ 3,651	$ -	$ -	$ 124,559

	December 31, 2014					
	Pass	Special Mention (4)	Substandard (5)	Doubtful (6)	Loss (7)	Total
Residential real estate	$ 53,618	$ -	$ 1,366	$ -	$ -	$ 54,984
Consumer	6,758	-	-	-	-	6,758
Commercial real estate	46,857	2,638	1,948	-	-	51,443
Commercial	5,946	99	218	-	-	6,263
Total	$ 113,179	$ 2,737	$ 3,532	$ -	$ -	$ 119,448

The Company categorized each loan into credit risk categories based on current financial information, overall debt service coverage, collateral coverage, historical payment experience, and current economic trends. The Company uses the following definitions for credit risk ratings:

Risk Ratings 1-3 (Pass) - All loans in risk ratings 1-3 are considered to be acceptable credit risks by the Company and are grouped for the purposes of allowance for loan loss considerations and financial reporting. The three ratings essentially represent a ranking of loans that are all viewed to be of acceptable credit quality, taking into consideration the various factors mentioned above, but with varying degrees of financial strength, debt coverage, management, and factors that could impact credit quality.

Risk Rating 4 (Special Mention) - A special mention business credit has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects or in the Company's credit position at some future date. Special mention business credits are not adversely ranked and do not expose the Company to sufficient risk to warrant adverse ranking.

Note 3 - Loans (Continued)

Risk Rating 5 (Substandard) - A substandard business credit is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Business credits classified as substandard must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. If the likelihood of full collection of interest and principal may be in doubt, such loans are placed on nonaccrual status.

Risk Rating 6 (Doubtful) - A business credit rated as doubtful has all the weaknesses inherent in substandard as risk rating 5 with the added characteristic that the weaknesses make collection or liquidation in full, on the basis or currently existing facts, conditions, and values, highly questionable and improbable. Due to the high probability of loss, nonaccrual treatment is required for doubtful rated loans.

Risk Rating 7 (Loss) - A business credit rated as loss is considered uncollectible and of such little value that its continuance as a collectible loan is not warranted. This rating does not necessarily result in absolutely no recovery or salvage value, but rather it is not practical or desirable to defer charging off even if partial recovery may be a consideration in the future.

Age Analysis of Past Due Loans

The following schedule represents the aging analysis of past due loans by loan type at December 31 reported (000s omitted):

	December 31, 2015						
	30-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing	Nonaccrual Loans
Residential real estate	$ 725	$ 316	$ 1,041	$ 54,584	$ 55,625	$ 105	$ 509
Consumer	4	-	4	6,427	6,431	-	-
Commercial real estate	115	285	400	53,703	54,103	-	708
Commercial	-	-	-	8,400	8,400	-	187
Total	$ 844	$ 601	$ 1,445	$ 123,114	$ 124,559	$ 105	$ 1,404

	December 31, 2014						
	30-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment > 90 Days and Accruing	Nonaccrual Loans
Residential real estate	$ 851	$ 265	$ 1,116	$ 53,868	$ 54,984	$ -	$ 265
Consumer	76	-	76	6,682	6,758	-	-
Commercial real estate	138	130	268	51,175	51,443	-	587
Commercial	-	-	-	6,263	6,263	-	213
Total	$ 1,065	$ 395	$ 1,460	$ 117,988	$ 119,448	$ -	$ 1,065

Note 3 - Loans (Continued)

Impaired Loans

As described in Note 1, a loan is impaired when full payment under the loan terms is not expected. Impairment is evaluated in total for smaller balance homogenous loans of similar nature, such as residential mortgage, consumer, and credit card loans, and on an individual loan basis for other loans. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Impaired loans are presented in the tables below (000s omitted):

As of and for the Year Ended December 31, 2015	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment for the Year	Interest Income Recognized for the Year
With no related allowance recorded:					
Residential real estate	$ 9	$ 9	$ -	$ 178	$ 1
Commercial real estate	477	477	-	789	2
Subtotal	$ 486	$ 486	$ -	$ 967	$ 3
With an allowance recorded:					
Residential real estate	$ 1,582	$ 1,582	$ 167	$ 1,300	$ 78
Commercial real estate	4,041	4,041	320	3,822	189
Commercial	205	205	188	221	1
Subtotal	5,828	5,828	675	5,343	268
Total	$ 6,314	$ 6,314	$ 675	$ 6,310	$ 271

As of and for the Year Ended December 31, 2014	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment for the Year	Interest Income Recognized for the Year
With no related allowance recorded:					
Residential real estate	$ 348	$ 348	$ -	$ 851	$ 2
Commercial real estate	1,100	1,100	-	223	38
Subtotal	$ 1,448	$ 1,448	$ -	$ 1,074	$ 40
With an allowance recorded:					
Residential real estate	$ 1,017	$ 1,018	$ 110	$ 968	$ 48
Commercial real estate	3,603	3,603	446	3,887	5
Commercial	238	238	155	136	2
Subtotal	4,858	4,859	711	4,991	55
Total	$ 6,306	$ 6,307	$ 711	$ 6,065	$ 95

Note 3 - Loans (Continued)

Troubled Debt Restructurings

The following schedule represents the modification activity for loans considered troubled debt restructurings that were modified during the years ended December 31, 2015 and 2014 (000s omitted, except number of contracts):

	2015			2014		
	Number of Contracts	Pre-modification Outstanding Recorded	Post-modification Outstanding Recorded	Number of Contracts	Pre-modification Outstanding Recorded	Post-modification Outstanding Recorded
Residential real estate	2	$ 361	$ 378	3	$ 64	$ 68
Commercial real estate	1	195	195	1	1,225	1,225
Total	3	$ 556	$ 573	4	$ 1,289	$ 1,293

There were no loans modified as TDRs within the previous 12 months that subsequently became 30 days or more past due during the years ended December 31, 2015 or 2014.

Note 4 - Loan Servicing

Mortgage servicing rights are included in other assets on the consolidated balance sheet. For the two years ended December 31, activity for capitalized mortgage servicing rights was as follows (000s omitted):

	2015	2014
Beginning of year	$ 660	$ 652
Additions	66	62
Amortization	(35)	(54)
Total	$ 691	$ 660

The fair value of mortgage servicing rights is estimated by calculating the present value of estimated future net servicing cash flows, taking into consideration the expected prepayment rates and other economic factors that are based on current market conditions. Increases in mortgage loan prepayments reduce estimated future net servicing cash flows because the life of the underlying loan is reduced. The fair value calculation is performed by a third-party model. Assumptions used in the 2015 model include an average prepayment rate of 10.94 percent and an average discount rate of 9.41 percent. Assumptions used in the 2014 model include an average prepayment rate of 10.37 percent and an average discount rate of 9.22 percent. The fair value of the mortgage servicing rights was last calculated as of November 30, 2015 and 2014 and had a fair value of approximately $800,000.

Mortgage loans serviced for others are not reported as assets. At December 31, 2015 and 2014, total mortgage loans serviced for others totaled $90,686,000 and $85,665,000, respectively. Related escrow deposit balances were $243,000 and $200,000 at December 31, 2015 and 2014, respectively.

Note 5 - Bank Premises and Equipment

Year-end premises and equipment were as follows (000s omitted):

	2015	2014
Real estate and buildings	$ 7,732	$ 7,435
Furniture, fixtures, and equipment	3,983	4,050
Construction in progress	307	-
Total	12,022	11,485
Accumulated depreciation	(6,504)	(6,486)
Net	$ 5,518	$ 4,999

Depreciation expense for the years ended December 31, 2015 and 2014 amounted to $328,000 and $358,000, respectively.

Note 6 - Other Real Estate Owned

During 2015 and 2014, the Bank foreclosed on certain loans secured by real estate and transferred this real estate collateral to other real estate in each of those years. At the time of acquisition, amounts were charged off against the allowance for loan losses to bring the carrying amount of these properties to their estimated fair value, less estimated costs to sell. Activity in other real estate owned is as follows for the years ended December 31, 2015 and 2014 (000s omitted):

	2015	2014
Balance at beginning of year	$ 309	$ 662
Transfers from loans	360	113
Sales	(449)	(655)
Gain on sales	67	204
Write-down adjustments and loss on sales	(70)	(15)
Total	$ 217	$ 309

Management periodically reviews the other real estate owned properties for a valuation allowance to determine if the values of these properties have declined since the date of acquisition.

Note 7 - Deposits

The following is a summary of the distribution of deposits at year end (000s omitted):

	2015	2014
Noninterest-bearing deposits	$ 63,131	$ 51,169
NOW accounts	47,986	42,151
Savings and money market accounts	89,409	86,114
Time:		
Under $250,000	37,012	42,468
$250,000 and over	5,634	5,073
Total	$ 243,172	$ 226,975

Total time deposits between $100,000 and $250,000 were approximately $20,929,000 at December 31, 2015. At December 31, 2015, the scheduled maturities of time deposits are as follows (000s omitted):

2016	$ 24,836
2017	10,846
2018	4,697
2019	1,389
2020	878
Total	$ 42,646

Note 8 - Employee Benefits

Defined Benefit Retirement Plan - The Company has a defined benefit, noncontributory pension plan. The plan was amended to no longer accept new participants as of December 31, 2008. Current participants will receive benefits as originally outlined in the plan. The Company uses a December 31 measurement date for its plan. The plan's funded status is recorded within other assets on the accompanying consolidated balance sheet. The following sets forth the plan's funded status and amounts recognized in the consolidated financial statements (000s omitted):

	2015	2014
Change in benefit obligation:		
Beginning benefit obligation	$ (5,702)	$ (5,185)
Service cost	(208)	(201)
Interest cost	(312)	(283)
Actuarial loss (gain)	276	(377)
Benefits paid	509	344
Ending benefit obligation	(5,437)	(5,702)
Change in plan assets, at fair value:		
Beginning plan assets	6,059	6,038
Actual return	(110)	365
Benefits paid	(508)	(344)
Ending plan assets	5,441	6,059
Funded status	$ 4	$ 357

The accumulated benefit obligation for the defined benefit pension plan was $4,442,000 and $4,264,000 at December 31, 2015 and 2014, respectively.

Components of net periodic benefit cost are as follows (000s omitted):

	2015	2014
Service cost	$ 208	$ 201
Interest cost on benefit obligation	312	283
Expected return on plan assets	(482)	(480)
Net amortization and deferral	125	96
Pension expense	162	100

The estimated net loss and prior service cost for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are approximately $144,000 and $4,000, respectively.

Note 8 - Employee Benefits (Continued)

Assumptions

The following weighted average assumptions were used to determine benefit obligations at year end and net cost:

	2015	2014
Weighted average discount	5.50 %	5.50 %
Rate of increase in future compensation	3.00	3.00
Expected long-term return on plan assets	8.00	8.00

The Company's target allocation at December 31, 2015 was 40 percent equity securities and 60 percent fixed-income securities. The Company's target allocation at December 31, 2014 was 30 percent equity securities and 70 percent fixed-income securities. The Company's pension plan asset allocation at December 31, 2015 and 2014 and expected long-term rate of return by asset category are as follows:

	Percentage of Plan Assets at Year End		Weighted-average Expected Long-term Rate of Return
	2015	2014	2016
Equity securities	41.20 %	33.40 %	3.30 %
Fixed-income securities	58.80	66.60	4.70
Total	100.00	100.00	8.00

The weighted average expected long-term rate of return is an estimate based on past performance and actual returns in the future are likely to vary over time.

The asset mix of the portfolio will be maintained by periodically rebalancing this account back to the stock and fixed income target allocations stated above.

The investments in the plan are managed for the benefits of the participants. They are structured to meet the cash flow necessary to pay retiring employees. ERISA guidelines for diversification of the investments are followed.

In 2015 and 2014, the Company made no contributions to this pension plan.

All pension assets were invested in a lifestyle mutual fund comprised of equity and fixed-income securities as of December 31, 2015 and 2014. The fund is valued at net asset value per share, which the plan uses as a practical expedient for fair value.

Note 8 - Employee Benefits (Continued)

The following benefit payments, which reflect expected future service, are anticipated (000s omitted):

Year Ended	Benefit Payments
2016	$ 65
2017	64
2018	100
2019	219
2020	272
2021-2026	1,910

Deferred Compensation Plan - The Company has a deferred compensation plan to provide retirement benefits to certain directors, at their option, in lieu of annual directors' fees. The plan was amended as of December 31, 2009 and participants are no longer able to defer compensation in accordance with this plan and no additional benefits accrue under this plan. The present value of future benefits was accrued annually over the period of active service of each participant using a 6.00 percent discount rate. Total liabilities under this plan are $2,246,000 and $2,434,000 at December 31, 2015 and 2014 and are included in other liabilities on the consolidated balance sheet. The expense for the plan was $155,000 and $163,000 in 2015 and 2014, respectively. Distributions under the plan were $343,000 and $355,000 in 2015 and 2014, respectively.

The following benefit payments reflect expected future cash flows as anticipated (000s omitted):

Year Ended	Benefit Payments
2016	$ 342
2017	342
2018	342
2019	342
2020	278
2021-2031	1,246

Note 8 - Employee Benefits (Continued)

The Company also has a deferred compensation plan that allows executive officers of the Bank and certain directors an opportunity to defer a portion of their compensation. On a monthly basis, the account of each participant accrues interest based on the interest rate determined for that year. Total liabilities under the plan are $986,000 and $918,000 at December 31, 2015 and 2014, respectively. The interest expense of the plan was $34,000 and $31,000 in 2015 and 2014, respectively. Distributions under the plan were $80,000 and $28,000 in 2015 and 2014, respectively. Employee deferrals into the plan were $114,000 and $72,000 in 2015 and 2014, respectively.

401(k) Plan - The Company has a 401(k) savings and retirement plan covering substantially all employees. Under the plan, employees may defer up to the lesser of 100 percent of their eligible compensation or the limitations set by the IRS. The employees may also make "catch up" contributions to the extent the IRS allows. During 2015 and 2014, the board of directors elected to contribute a matching contribution equal to 100 percent of the first 1 percent. Effective April 1, 2013, the board elected to match 100 percent of the first 5 percent for those employees not eligible to participate in the employee pension plan. Employee contributions and the Company's matching contributions are vested immediately. The Company's matching percentages are determined annually by the board of directors and resulted in total contributions of $52,000 and $46,000 in 2015 and 2014, respectively.

Note 9 - Income Taxes

Income tax expense consists of (000s omitted):

	2015	2014
Current expense	$ -	$ 30
Deferred expense	374	757
Total income tax expense	$ 374	$ 787

The primary difference in the Company's effective tax rate and the statutory federal rate of 34 percent is due to non-taxable income on bank owned life insurance and municipal investments.

Note 9 - Income Taxes (Continued)

The details of the net deferred tax asset (liability) are as follows (000s omitted):

	2015	2014
Deferred tax assets:		
Allowance for loan losses	$ 136	$ 238
Deferred compensation	1,099	1,140
Capital loss carryforward	340	340
Pension liability	916	763
Net operating loss	360	908
AMT tax credits	499	395
Unrealized losses on securities available for sale	6	-
Other	248	156
Total deferred tax assets	3,604	3,940
Deferred tax liabilities:		
Pension	(911)	(966)
Fixed assets	(227)	(226)
Mortgage servicing rights	(235)	(225)
Unrealized gains on securities available for sale	-	(80)
Other	(36)	(201)
Total deferred tax liability	(1,409)	(1,698)
Net valuation allowance for capital losses	(340)	(340)
Net deferred tax asset	$ 1,855	$ 1,902

Net operating loss carryforwards of approximately $1.1 million will expire between 2031 and 2034.

Note 10 - Related Party Transactions

Certain directors and executive officers of the Company and the Bank (including family members, affiliates, and companies in which they are principal owners) had loans outstanding with the Bank in the ordinary course of business. Related party loan balances totaled $1,471,000 and $777,000 at December 31, 2015 and 2014, respectively. Related party deposits totaled $7,332,000 and $8,314,000 at December 31, 2015 and 2014, respectively.

Note 11 - Commitments, Off-Balance Sheet Risk, and Contingencies

There are various contingent liabilities that are not reflected in the consolidated financial statements, including claims and legal actions arising in the ordinary course of business. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material effect on the financial condition or result of operations of the Company.

At December 31, 2015, the Bank had a required reserve of $151,000 made up of deposits with the Federal Reserve or as cash on hand. There was no required reserves as of December 31, 2014. These reserves do not earn interest.

Some financial instruments are used in the normal course of business to meet the financing needs of customers and to reduce exposure to interest rate changes. These financial instruments include commitments to extend credit and standby letters of credit. These involve, to a varying degree, credit and interest-rate risk in excess of the amount reported in the consolidated financial statements.

Exposure to credit loss if the other party does not perform is represented by the contractual amount for commitments to extend credit and standby letters of credit. The same credit policies are used for commitments and conditional obligations as are used for loans.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the commitment. 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 used, the total commitments do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments to guarantee a customer's performance to a third party.

A summary of the unused contractual amounts of financial instruments with off-balance-sheet risk at year end were as follows (000s omitted):

	2015	2014
Commitments to extend credit	$ 20,641	$ 22,567
Standby letters of credit	501	455

The fair values of these commitments are not material. Substantially all of these commitments are at variable or uncommitted rates.

Note 12 - Fair Value Measurements

The Company utilizes fair value measurements to record fair value adjustments of certain assets and liabilities and to determine fair value disclosure. The following presents information about the Company's assets measured at fair value on a recurring basis at December 31, 2015 and 2014 and the valuation techniques used by the Company to determine those fair values.

Fair Value Hierarchy

Under ASC 820, the Company groups assets and liabilities at fair value into three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1: In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets that the Company has the ability to access.

Level 2: Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs included quoted prices for similar assets in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3: Inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related assets or liabilities.

In instances whereby inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The Company's assessment of the significance of particular inputs to these fair value measurements required judgment and considers factors specific to each asset.

The Company uses the following methods and significant assumptions to estimate fair value.

Note 12 - Fair Value Measurements (Continued)

Securities classified as available for sale are generally reported at fair value utilizing Level 2 inputs, whereby the Company obtains fair value measurements from an independent pricing service which uses matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows and the bonds' terms and conditions, among other things. Securities in Level 1 include preferred stock securities. Securities in Level 2 include U.S. government agencies, mortgage-backed securities, corporate obligations, and state and municipal securities. The state and municipal portfolio also contains obligations issued by local municipalities and do not have a registered CUSIP. These bonds are classified based on Level 3 inputs. Additionally, the Company's auction rate securities, which are rarely traded, are also classified based on Level 3 inputs. Based on the lack of observable market data, the Company estimated fair values based on the observable data available and reasonable unobservable market data. The Company estimated fair value based on a discounted cash flow model, which used appropriately adjusted discount rates reflecting credit and liquidity risks.

Investment securities available for sale are valued primarily by a third-party pricing agent. Prices supplied by the independent pricing agent, as well as their pricing methodologies and assumptions, are reviewed for reasonableness and to ensure such prices are aligned with traditional pricing matrices. In general, our investment securities do not possess a complex structure that could introduce greater valuation risk. Pricing for such instruments is fairly generic and is easily obtained. On a quarterly basis, prices supplied by the pricing agent are validated by comparison to prices obtained from other third-party sources for a material portion of the portfolio.

Both the market and income valuation approaches are implemented using the following types of inputs:

- Government-sponsored agency debt securities and corporate bonds are primarily priced using available market information through processes such as benchmark curves, market valuations of like securities, sector groupings, and matrix pricing.
- Other government-sponsored mortgage-backed securities are primarily priced using available market information including benchmark yields, prepayment speeds, spreads, and volatility of similar securities.
- Corporate obligations are primarily priced using consensus pricing and dealer quotes.

Note 12 - Fair Value Measurements (Continued)

- State and municipal bonds are largely grouped by characteristics, i.e., geographical data and source of revenue in trade dissemination systems. Since some securities are not traded daily and due to other grouping limitations, active market quotes are often obtained using benchmarking for like securities. Local tax anticipation warrants, with very little market activity, are priced using an appropriate market yield curve.
- Auction rate securities are valued based on an expected cash flow valuation using the interest rate of the underlying securities. The securities owned by the Company are rarely traded and have an illiquid market.
- Preferred shares are primarily priced using the market approach and utilizing live data feeds from active market exchanges for identical securities.

Disclosures concerning assets measured at fair value are as follows:

Assets Measured at Fair Value on a Recurring Basis at December 31, 2015

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2015
Assets				
Investment securities available for sale (000s omitted):				
U.S. government and agency	$ -	$ 32,894	$ -	$ 32,894
Mortgage-backed	-	22,200	-	22,200
State and municipal	-	-	16,742	16,742
Collateralized mortgage obligations	-	14,854	-	14,854
Total investment securities available for sale	$ -	$ 69,948	$ 16,742	$ 86,690

Note 12 - Fair Value Measurements (Continued)

Assets Measured at Fair Value on a Recurring Basis at December 31, 2014

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2014
Assets				
Investment securities available for sale (000s omitted):				
U.S. government and agency	$ -	$ 34,270	$ -	$ 34,270
Mortgage-backed	-	20,592	-	20,592
State and municipal	-	-	18,927	18,927
Collateralized mortgage obligations	-	19,317	-	19,317
Total investment securities available for sale	$ -	$ 74,179	$ 18,927	$ 93,106

Changes in Level 3 assets measured at fair value on a recurring basis for the years ended December 31, 2014 and 2015 (000s omitted) are as follows:

	Investment Securities Available for Sale
Balance at January 1, 2015	$ 18,927
Net purchases, sales, calls, and maturities	(2,219)
Total unrealized losses	(34)
Balance at December 31, 2015	$ 16,674

	Investment Securities Available for Sale
Balance at January 1, 2014	$ 19,520
Net purchases, sales, calls, and maturities	(711)
Total realized gains	360
Total unrealized losses	(242)
Balance at December 31, 2014	$ 18,927

Note 12 - Fair Value Measurements (Continued)

Both observable and unobservable inputs may be used to determine the fair value of positions classified as Level 3 assets. As a result, the unrealized gains and losses for these assets presented in the tables above may include changes in fair value that were attributable to both observable and unobservable inputs.

During 2015, there were no sales of Level 3 investments. During 2014, one Level 3 investment was sold for proceeds of approximately $1,360,000. The investment had an original cost of $2,000,000 and was written down to $1,000,000 through OTTI in a previous year, resulting in a $360,000 gain upon sale.

The Company also reviews the fair value of certain assets and, if necessary, adjusts the carrying value of the assets to fair value on a nonrecurring basis.

Impaired loans categorized as Level 3 assets consist of non-homogeneous loans that are considered impaired and had write-downs to fair value during the period. The Company estimates the fair value of the loans based on the present value of expected future cash flows using management's best estimate of key assumptions. These assumptions include future payments ability, timing of payment streams, and estimated realizable values of available collateral (typically based on outside appraisals).

The Company's other real estate owned is held at an estimated realizable value and that value changes periodically with the real estate market. Losses for the period associated with other real estate owned represent valuation adjustments and write-downs through the income statement.

Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2015 (000s omitted)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2015
Assets				
Other real estate owned	$ -	$ -	$ 217	$ 217

Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2014 (000s omitted)

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at December 31, 2014
Assets				
Impaired loans	$ -	$ -	$ 265	$ 265
Other real estate owned	-	-	59	59

Note 13 - Fair Value of Financial Instruments

The following methods and assumptions were used to estimate fair values for financial instruments. The carrying amount is considered to approximate fair value for cash and variable rate loans or deposits that reprice frequently and fully. Securities fair values are based on quoted market prices or, if no quotes are available, on the rate and term of the security and on information about the issuer. For fixed-rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, the fair value is estimated by discounted cash flow analysis or underlying collateral values, where applicable. The fair value of off-balance-sheet items approximates cost and is not considered significant to this presentation.

The estimated year-end values of financial instruments were as follows (000s omitted):

	2015		2014	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets				
Cash and cash equivalents	$ 31,569	$ 31,569	$ 12,814	$ 12,814
Time deposits with other financial institutions	8,711	8,730	7,547	7,559
Securities available for sale	86,690	86,690	93,106	93,106
Securities held to maturity	4,835	4,990	6,529	6,756
Other securities	905	905	972	972
Loans held for sale	369	380	295	300
Loans, net	122,936	136,778	117,591	132,134
Accrued interest receivable on loans	370	370	419	419
Financial Liabilities				
Deposits	243,172	243,303	226,975	226,980
Accrued interest payable	9	9	12	12

Note 14 - Regulatory Capital

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

Note 14 - Regulatory Capital (Continued)

Beginning in 2015, banks transitioned to the new federal banking agencies' revisions to the capital rules, which incorporated certain changes to the Basel capital framework, including Basel III and other elements. These regulations are considered in the 2015 ratios below and include several provisions such as the implementation of a Common Equity Tier 1 ratio, modifications to risk weightings of certain assets, and a phase-in of a capital conservation buffer and threshold deductions of certain instruments' inclusion in capital.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total, common equity Tier 1, and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2015 and 2014, that the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2015, the most recent notification from the Bank's primary regulator categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk based, common equity Tier 1 risk based, Tier 1 risk based, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category.

Note 14 - Regulatory Capital (Continued)

The minimum requirements (000s omitted) are as follows:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2015						
Common equity tier 1 capital to risk weighted assets:						
Bank	$ 24,455	18.4 %	$ 5,984	4.5 %	$ 8,644	6.5 %
Total capital to risk weighted assets:						
Bank	25,964	19.5	10,639	8.0	13,298	10.0
Tier 1 capital to risk weighted assets:						
Bank	24,455	18.4	5,319	4.0	7,979	6.0
Tier 1 capital to average assets:						
Bank	24,455	9.0	10,821	4.0	13,526	5.0
As of December 31, 2014						
Total capital to risk weighted assets:						
Bank	$ 24,514	18.9 %	$ 10,352	8.0 %	$ 12,941	10.0 %
Tier 1 capital to risk weighted assets:						
Bank	22,896	17.7	5,176	4.0	7,764	6.0
Tier 1 capital to average assets:						
Bank	22,896	8.9	10,308	4.0	12,885	5.0

One of the principal sources of cash for the Company is dividends from the Bank. Regulatory agencies can place dividend restrictions on the Bank based on their evaluation of its financial condition. No restrictions are currently imposed by regulatory agencies on the Bank other than the limitations found in the regulations which govern the payment of dividends to the Company. Under the most restrictive of these regulations, in 2015, the Bank is limited to paying dividends of the Company's net income of 2015 and the retained net income of the prior two calendar years.

OFFICERS OF CNB CORPORATION AND CITIZENS NATIONAL BANK

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PRESIDENT AND CHIEF EXECUTIVE OFFICER
CYRIL S. DRIER
SENIOR VICE PRESIDENT
NANCY A. STEMPKY
TREASURER
REBECCA L. TOMASKI
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CITIZENS NATIONAL BANK OFFICERS

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Sally A. Spray

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Carolyn A. Scheele

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Kelly L. Leist
Merry Major-Brown

DIRECTORS OF CNB CORPORATION & CITIZENS NATIONAL BANK

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Chairman, Citizens National Bank
Retired President, Anchor In Marina of Northern Michigan, Inc.

STEVEN J. BAKER, D.V.M.
Retired, Indian River Veterinary Clinic

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Vice President & Secretary
Albert Ellenberger Lumber Company

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President & Chief Executive Officer, CNB Corporation
President & Chief Executive Officer, Citizens National Bank

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Retired, Partner, Bodman LLP

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President, Tube Fab

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President, Shepler's Mackinac Island Ferry Service

R. JEFFERY SWADLING
Vice President, Ken's Village Market

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Owner, Tromble Bay Farms
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FRANCIS J. VANANTWERP, JR
JOHN P. WARD

CNB CORPORATION COMMON STOCK

CNB Corporation common stock is listed on the OTC Markets and is traded under the symbol "CNBZ." The Company had 918 shareholders as of December 31, 2015.

SHAREHOLDER RELATIONS AND ANNUAL REPORT AVAILABLE

Shareholders may obtain, without charge, a copy of the 2015 Annual Report by submitting a written request to:

Shareholder Relations
CNB Corporation
303 N. Main St. P.O. Box 10,
Cheboygan, Michigan 49721.

The reports can also be downloaded from www.cnbismybank.com. Click on the shareholder relations link.

WEBSITE INFORMATION

The most current news releases and CNB Corporation financial reports and product information are available at our website, www.cnbismybank.com.

ANNUAL MEETING

The Annual Meeting of Shareholders will be held on Tuesday, May 17, 2016 at the Knights of Columbus Hall, 9840 N. Straits Highway, Cheboygan, Michigan, 49721 at 5:30 p.m.

INDEPENDENT AUDITOR

Plante & Moran, PLLC
Grand Rapids, Michigan

STOCK SALES & MARKET MAKERS

Stock sales can be handled by stockbrokers serving as market makers. You may work with a broker of your choice or facilitate a private party sale. Market information for CNB Corporation is identified on the OTC Markets website at www.otcmarkets.com.

TRANSFER AGENT

The transfer agent for CNB Corporation continues to be Citizens National Bank. Inquiries regarding a change of name, address or ownership of stock, as well as information on shareholder records, lost or stolen certificates should be directed to shareholder relations.

The following table presents the high and low selling prices of known transactions in common stock of the Company for each quarter of 2015 and 2014:

	2015			2014		
	Market Price		Cash Dividends	Market Price		Cash Dividends
Quarter	High	Low	Declared	High	Low	Declared
1st	$16.67	$14.00	$ -	$ 12.45	$ 10.65	$ 0.10
2nd	$17.00	$15.00	$ -	$ 13.00	$ 11.95	$ 0.10
3rd	$17.00	$15.60	$ 0.15	$ 14.00	$ 12.50	$ -
4th	$16.45	$16.00	$ -	$ 15.00	$ 13.25	$ 0.10