CNB
CORPORATION

2014
ANNUAL REPORT

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

Contents

CNB CORPORATION
ANNUAL SHAREHOLDERS' MEETING

Tuesday, May 19, 2015, 7:00 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, which comprise the consolidated balance sheet as of December 31, 2014 and 2013, 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 and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free 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, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Plante & Moran, PLLC

March 26, 2015

CNB Corporation

Consolidated Balance Sheet
(000s omitted, except per share data)

		December 31, 2014		December 31, 2013
Assets				
Cash and due from banks	$	6,573	$	8,424
Interest-bearing deposits with other financial institutions		6,241		1,672
Total cash and cash equivalents		12,814		10,096
Time deposits with other financial institutions		7,547		11,169
Investment securities - Available for sale (Note 2)		93,106		84,374
Investment securities - Held to maturity (Note 2)		6,529		5,726
Other securities		972		997
Loans held for sale		295		882
Loans - Net of allowance for loan losses of $1,726 and $3,076 (Note 3)		117,591		118,492
Premises and equipment (Note 5)		4,999		5,109
Other assets (Notes 4, 8, and 10)		10,068		10,890
Total assets	**$**	**253,921**	**$**	**247,735**
Liabilities and Stockholders' Equity				
Liabilities				
Deposits (Note 7):				
Noninterest-bearing	$	51,169	$	54,045
Interest-bearing		175,806		168,768
Total deposits		226,975		222,813
Accrued and other liabilities		4,208		4,102
Total liabilities		231,183		226,915
Stockholders' Equity				
Common stock- $2.50 par value; 2,000,000 shares authorized; 1,212,098 shares issued and outstanding in 2014 and 2013		3,030		3,030
Additional paid-in capital		19,499		19,499
Retained earnings		1,691		164
Accumulated other comprehensive loss, net of tax		(1,482)		(1,873)
Total stockholders' equity		22,738		20,820
Total liabilities and stockholders' equity	**$**	**253,921**	**$**	**247,735**

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

	Year Ended December 31, 2014	Year Ended December 31, 2013
Interest Income		
Loans - Including fees	$ 6,847	$ 6,562
Debt securities:		
Taxable	1,159	944
Tax-exempt	236	264
Other	122	151
Total interest income	8,364	7,921
Interest Expense	384	724
Net Interest Income	7,980	7,197
Recapture of Loan Losses (Note 3)	(900)	(400)
Net Interest Income After Recapture of Loan Losses	8,880	7,597
Noninterest Income		
Service charges and fees	947	955
Net gain on sale of loans and mortgage banking income	246	465
Net gain on sale of securities	422	364
Securities impairment recovery	-	1,445
Loan servicing fees, net of amortization	158	82
Gain on the sale of other real estate owned	204	215
Other	341	389
Total noninterest income	2,318	3,915
Noninterest Expense		
Salaries and employee benefits	3,752	3,743
Occupancy and equipment	1,046	1,011
System conversion costs	476	-
FDIC premiums	238	344
Deferred compensation	194	152
Pension	100	210
Hospitalization	496	593
Legal and professional	635	581
Other	1,583	1,028
Total noninterest expense	8,520	7,662
Income - Before income taxes	2,678	3,850
Income Tax Expense	787	1,130
Net Income	**$ 1,891**	**$ 2,720**
Earnings per Share		
Basic	**$ 1.56**	**$ 2.24**
Diluted	**$ 1.56**	**$ 2.24**

See Notes to Consolidated Financial Statements.

Consolidated Statement of Comprehensive Income

(000s omitted, except per share data)

	Year Ended December 31, 2014	Year Ended December 31, 2013
Net Income	$ 1,891	$ 2,720
Other Comprehensive Income (Loss)		
Unrealized gain (loss) on securities:		
Gain (loss) arising during the year	1,410	(1,109)
Reclassification adjustment for gains recognized on securities sold	(422)	(364)
Total unrealized gain (loss) on securities	988	(1,473)
Defined benefit pension:		
Net (loss) gain during the period	(400)	718
Prior service cost recognized during period	4	4
Total defined benefit pension	(396)	722
Tax effects	(201)	256
Total other comprehensive income (loss)	391	(495)
Comprehensive Income	**$ 2,282**	**$ 2,225**

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	Total
Balance - January 1, 2013	1,212,098	$ 3,030	$ 19,499	$ (2,435)	$ (1,378)	$ 18,716
Net income	-	-	-	2,720	-	2,720
Other comprehensive loss	-	-	-	-	(495)	(495)
Dividends declared $0.10 per share	-	-	-	(121)	-	(121)
Balance - December 31, 2013	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**

See Notes to Consolidated Financial Statements.

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

	Year Ended December 31 2014	2013
Cash Flows from Operating Activities		
Net income	$ 1,891	$ 2,720
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	728	998
Provision for loan losses	(900)	(400)
Loans originated for sale	(9,546)	(21,427)
Proceeds from sales of loans originated for sale	9,730	20,865
Gain on sales of investment securities	(422)	(364)
Gain on sale of loans	(183)	(465)
Gain on sales of other real estate owned properties	(204)	(215)
Other real estate owned writedowns	15	15
Increase in cash surrender value of life insurance	(146)	(119)
Deferred tax expense	757	255
Decrease in other assets	1,250	785
Increase in other liabilities	107	510
Net cash provided by operating activities	3,077	3,158
Cash Flows from Investing Activities		
Proceeds from sales of securities available for sale	2,433	22,270
Proceeds from maturities of securities available for sale	16,124	14,353
Purchase of securities available for sale	(27,239)	(23,797)
Proceeds from maturities of securities held to maturity	1,821	2,381
Purchase of securities held to maturity	(2,625)	(3,600)
Proceeds from maturities of time deposits	3,622	4,227
Purchase of time deposits	-	(1,246)
Net change in portfolio loans	2,275	(12,263)
Redemption of other securities	25	-
Premises and equipment expenditures	(248)	(325)
Proceeds from sales and redemptions of other real estate owned properties	655	1,613
Purchase of bank owned life insurance policies	(1,000)	-
Net cash (used in) provided by investing activities	(4,157)	3,613
Cash Flows from Financing Activities		
Net increase (decrease) in deposit accounts	4,162	(15,054)
Dividends paid	(364)	(121)
Net cash provided by (used in) financing activities	3,798	(15,175)
Net Increase (Decrease) in Cash and Due from Banks	2,718	(8,404)
Cash and Due from Banks - Beginning of year	10,096	18,500
Cash and Due from Banks - End of year	**$ 12,814**	**$ 10,096**
Supplemental Cash Flow Information		
Cash paid for:		
Interest	$ 385	$ 742
Income taxes	30	51
Transfer from loans to other real estate owned	113	1,118

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 balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of investment securities, foreclosed real estate, deferred tax assets, mortgage servicing rights, 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 where 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 five years while the useful life for buildings is thirty-nine 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 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 revenues. 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.

Company Owned Life Insurance - The Bank has purchased life insurance policies on certain directors and executives. Company owned life insurance is recorded at its cash surrender value, or the amount that can be effectively realized at the balance sheet date. At December 31, 2014 and 2013, the cash surrender value of the underlying policies was $5,538,000 and $4,392,000, which is included in other assets on the 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 12.

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 gains (losses) on securities and defined benefit pension obligation of approximately $157,000 and ($1,639,000), respectively, in 2014 and ($495,000) and ($1,378,000), respectively, in 2013.

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, 2014 or 2013. Accordingly, no dilutive impact is presented.

Recent Accounting Pronouncement - 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 nonpublic entities for annual reporting periods beginning after December 15, 2017 (therefore, for the year ending December 31, 2018 for the Company). Early adoption is permitted for nonpublic companies with certain caveats. Management is currently assessing the impact to the Company's consolidated financial statements.

Subsequent Events - The financial statements and related disclosures include evaluation of events up through and including March 26, 2015, which is the date the financial statements were available to be issued.

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):

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

	2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Available-for-sale securities:				
U.S. Government and agency	$ 30,350	$ 52	$ (74)	$ 30,328
Mortgage-backed	16,249	15	(281)	15,983
Collateralized mortgage obligations	19,155	-	(612)	18,543
State and municipal	18,370	244	(94)	18,520
Auction rate securities	1,000	-	-	1,000
Total available-for-sale securities	85,124	311	(1,061)	84,374
Held-to-maturity securities:				
State and municipal	5,726	288	-	6,014
Total available-for-sale and held-to-maturity securities	$ 90,850	$ 599	$ (1,061)	$ 90,388

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.

When OTTI occurs, the amount of the OTTI recognized in earnings depends on whether we intend to sell the security or it is more likely than not we will be required to sell the security before recovery of its amortized cost basis. If we intend to sell or it is more likely than not we will be required to sell the security before recovery of its amortized cost basis, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. The previous amortized cost basis less the OTTI recognized in earnings becomes the new amortized cost basis of the investment. If a security is determined to be other-than-temporarily impaired, but we do not intend to sell the security, only the credit portion of the estimated loss is recognized in earnings, with the other portion of the loss recognized in other comprehensive income.

During 2013, the Company sold 15 investments. Proceeds from the sales were $22,270,000 and gains of $385,000 and losses of $21,000 were recorded from the sales. Additionally, in 2013, recoveries of $1,445,000 were received from previously written off bonds. During 2014, the Company sold two investments. Proceeds from the sale were $2,433,000 resulting in gains of $422,000. There were no losses recorded from the sales in 2014.

Contractual maturities of debt securities at year end 2014 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.

Note 2 - Securities (Continued)

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2014 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	$ 11,206	$ 11,223	$ 3,794	$ 3,800
Due in one through five years	36,386	36,447	2,080	2,197
Due after five years through ten years	4,962	5,125	655	759
Thereafter	330	402	-	-
Mortgage-backed securities	20,522	20,592	-	-
CMOs	19,463	19,317	-	-
Total	$ 92,869	$ 93,106	$ 6,529	$ 6,756

Securities pledged at December 31, 2014 and 2013 totaled $0 and $17.9 million, respectively, to secure borrowing capabilities with the Federal Home Loan Bank. The Company did not have any borrowings as of December 31, 2014 or 2013.

Securities with unrealized losses at year end 2014 and 2013, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (000s omitted):

	2014			
	Less than Twelve Months		Over Twelve 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

Note 2 - Securities (Continued)

	2013			
	Less than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
U.S. Government and agency	$ 8,893	$ (66)	$ 1,029	$ (8)
Mortgage-backed	11,328	(184)	3,534	(97)
Collateralized mortgage obligations	18,543	(612)	-	-
State and municipal	9,213	(81)	2,261	(13)
Total available-for-sale securities	$ 47,977	$ (943)	$ 6,824	$ (118)

Unrealized losses remaining on the balance sheet at year end 2014 and 2013 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 3 - Loans

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

	2014	2013
Residential real estate	$ 54,984	$ 56,368
Consumer	6,758	6,046
Commercial real estate	51,443	54,384
Commercial	6,263	5,081
Total	119,448	121,879
Less:		
Deferred fees	(131)	(311)
Allowance for credit losses	(1,726)	(3,076)
Net loans	$ 117,591	$ 118,492

Note 3 - Loans (Continued)

Activity in the allowance for loan losses for 2014 and 2013 is summarized as follows (000s omitted):

	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	$ 1,366	$ -	$ 4,703	$ 238	$ -	$ 6,307
Collectively evaluated for impairment	53,618	6,758	46,740	6,025	-	113,141
Ending loan balance	$ 54,984	$ 6,758	$ 51,443	$ 6,263	$ -	$ 119,448

	Year Ended December 31, 2013					
	Residential Real Estate	Consumer	Commercial Real Estate	Commercial	Unallocated	Total
Beginning balance	$ 220	$ 16	$ 3,026	$ 72	$ 304	$ 3,638
Charge-offs	(156)	(30)	(84)	-	-	(270)
Recoveries	21	25	49	13	-	108
Provision	337	(7)	(594)	(21)	(115)	(400)
Ending balance	$ 422	$ 4	$ 2,397	$ 64	$ 189	$ 3,076
Ending allowance balance attributable to loans:						
Individually evaluated for impairment	$ 113	$ -	$ 1,019	$ 12	$ -	$ 1,144
Collectively evaluated for impairment	309	4	1,378	52	189	1,932
Ending allowance balance	$ 422	$ 4	$ 2,397	$ 64	$ 189	$ 3,076
Loans:						
Individually evaluated for impairment	$ 1,190	$ -	$ 4,616	$ 34	$ -	$ 5,840
Collectively evaluated for impairment	55,178	6,046	49,768	5,047	-	116,039
Ending loan balance	$ 56,368	$ 6,046	$ 54,384	$ 5,081	$ -	$ 121,879

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 purposes of credit quality evaluation. All consumer loans were performing as of December 31, 2014 and 2013.

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 business loans. The following schedule presents the recorded investment of loans in the portfolio by risk rating categories at December 31, 2014 and 2013 (000s omitted):

	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

	December 31, 2013					
	Pass	Special Mention (4)	Substandard (5)	Doubtful (6)	Loss (7)	Total
Residential Real Estate	$ 55,911	$ -	$ 457	$ -	$ -	$ 56,368
Consumer	6,046	-	-	-	-	6,046
Commercial Real Estate	48,936	1,668	3,226	554	-	54,384
Commercial	4,847	222	12	-	-	5,081
Total	$ 115,740	$ 1,890	$ 3,695	$ 554	$ -	$ 121,879

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 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, 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

	December 31, 2013						
	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	$ 1,882	$ 143	$ 2,025	$ 54,343	$ 56,368	$ 143	$ 4
Consumer	17	-	17	6,029	6,046	-	-
Commercial Real Estate	32	1,164	1,196	53,188	54,384	-	1,996
Commercial	35	-	35	5,046	5,081	-	1
Total	$ 1,966	$ 1,307	$ 3,273	$ 118,606	$ 121,879	$ 143	$ 2,001

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 table below (000s omitted):

	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	$ 1,017	$ 110	$ 968	$ 48
Commercial Real Estate	3,604	3,604	446	3,887	5
Commercial	238	238	155	136	2
Subtotal	4,859	4,859	711	4,991	55
Total	$ 6,307	$ 6,307	$ 711	$ 6,065	$ 95

	As of and For the Year Ended December 31, 2013				
	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	$ 254	$ 254	$ -	$ 278	$ 12
Commercial Real Estate	445	445	-	3,186	79
Subtotal	$ 699	$ 699	$ -	$ 3,464	$ 91
With an allowance recorded:					
Residential Real Estate	$ 919	$ 919	$ 113	$ 1,008	$ 45
Commercial Real Estate	4,171	4,171	1,019	2,878	71
Commercial	34	34	12	39	2
Subtotal	5,124	5,124	1,144	3,925	118
Total	$ 5,823	$ 5,823	$ 1,144	$ 7,389	$ 209

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, 2014 and 2013 (000s omitted, except number of contracts):

	2014			2013		
	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	3	$ 64	$ 68	-	$ -	$ -
Commercial Real Estate	1	1,225	1,225	5	2,098	1,688
Total	4	$ 1,289	$ 1,293	5	$ 2,098	$ 1,688

Note 4 - Loan Servicing

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

	2014	2013
Beginning of year	$ 652	$ 616
Additions	62	145
Amortization	(54)	(128)
Reversal of impairment valuation allowance	-	19
Total	$ 660	$ 652

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 2014 model include an average prepayment rate of 10.37% and an average discount rate of 9.22%. Assumptions used in the 2013 model include an average prepayment rate of 10.04% and an average discount rate of 8.45%. The fair value of the mortgage servicing rights was last calculated as of November 30, 2014 and had a fair value of $819,000. At November 30, 2013 the fair value of the mortgage servicing rights was $824,000.

Mortgage loans serviced for others are not reported as assets. At December 31, 2014 and 2013, total mortgage loans serviced for others was $85,665,000 and $83,620,000, respectively. Related escrow deposit balances were $200,000 and $212,000 at December 31, 2014 and 2013, respectively.

Note 5 - Bank Premises and Equipment

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

	2014	2013
Real estate and buildings	$ 7,435	$ 7,399
Furniture, fixtures, and equipment	4,050	3,859
Total	11,485	11,258
Accumulated depreciation	(6,486)	(6,149)
Net	$ 4,999	$ 5,109

Depreciation expense for the years ended December 31, 2014 and 2013 amounted to $358,000 and $396,000, respectively.

Note 6 - Other Real Estate Owned

During 2014 and 2013 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. Gains or losses on the sale of other real estate are included in the noninterest income and noninterest expense, respectively, on the statement of income in the table below (000s omitted):

	2014	2013
Balance at beginning of year	$ 662	$ 957
Transfers from loans	113	1,118
Sales	(655)	(1,613)
Gain on sales	204	215
Write-down adjustments	(15)	(15)
Total	$ 309	$ 662

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):

	2014	2013
Noninterest-bearing deposits	$ 51,169	$ 54,045
NOW accounts	42,151	31,192
Savings and money market accounts	86,114	91,101
Time:		
Under $250,000	42,468	41,812
$250,000 and over	5,073	4,663
Total	$ 226,975	$ 222,813

Total time deposits between $100,000 and $250,000 were approximately $30,105,000 at December 31, 2014. At year-end 2014, the scheduled maturities of time deposits are as follows (000s omitted):

2015	$ 20,411
2016	16,260
2017	7,895
2018	1,684
2019	1,291
Total	$ 47,541

Note 8 - Employee Benefits

Defined Benefit Retirement Plan - The Company has a defined benefit, noncontributory pension plan which provides retirement benefits for the majority of the employees. 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 balance sheet. The following sets forth the plan's funded status and amounts recognized in the financial statements (000s omitted):

Note 8 - Employee Benefits (Continued)

		2014		2013
Change in benefit obligation:				
Beginning benefit obligation	$	(5,185)	$	(5,390)
Service cost		(201)		(216)
Interest cost		(283)		(293)
Actuarial loss		(377)		(22)
Benefits paid		344		736
Ending benefit obligation		(5,702)		(5,185)
Change in plan assets, at fair value:				
Beginning plan assets		6,038		5,231
Actual return		365		1,043
Employer contribution		-		500
Benefits paid		(344)		(736)
Ending plan assets		6,059		6,038
Funded status	$	357	$	853

The accumulated benefit obligation for the defined benefit pension plan was $4,264,000 and $3,964,000 at December 31, 2014 and 2013, respectively.

Amounts recognized in accumulated other comprehensive income consist of the following:

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

		2014		2013
Service cost	$	201	$	216
Interest cost on benefit obligation		283		293
Expected return on plan assets		(480)		(444)
Net amortization and deferral		96		145
Pension expense		100		210

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 $121,000 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:

	2014	2013
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 year end 2014 was 30 percent equity securities and 70 percent fixed-income securities. The Company's target allocation at year end 2013 was 70 percent equity securities and 30 percent fixed-income securities. The Company's pension plan asset allocation at year end 2014 and 2013 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
	2014	2013	2015
Equity securities	33.40 %	74.30 %	10.00 %
Fixed-income securities	66.60	24.00	7.00
Other	-	1.70	0.10
Total	100.00	100.00	8.00

Plan assets were transferred to John Hancock beginning in the fourth quarter of 2014. They were previously administered by CAPTRUST Financial Advisors. Plan assets are invested in diversifed mutual funds.

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.

Note 8 - Employee Benefits (Continued)

During 2014, the Company made no contribution to this pension plan. In 2013, the Company contributed $500,000 into the plan.

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

Year	Benefit Payments
2015	$ 66
2016	65
2017	65
2018	118
2019	254
2020-2025	1,981

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% discount rate. Total liabilities under this plan are $2,434,000 and $2,626,000 at December 31, 2014 and 2013 and are included in other liabilities on the balance sheet. The expense for the plan was $163,000 and $123,000 in 2014 and 2013. Distributions under the plan were $355,000 and $323,000 in 2014 and 2013, respectively.

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

Year	Benefit Payments
2015	$ 342
2016	342
2017	342
2018	342
2019	342
2020-2030	1,981

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 $918,000 and $843,000 at December 31, 2014 and 2013, respectively. The expense of the plan was $31,000 and $29,000 in 2014 and 2013, 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% 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 2014 and 2013 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 $46,000 and $36,000 in 2014 and 2013, respectively.

Note 9 - Stock Options

Stock Option Plan - The stockholders approved an incentive stock option plan in May 1996 under which up to 67,005 options, as adjusted for stock splits, were available to be issued at market prices to employees over a 10-year period. The right to exercise the options vested over a one-year period. The exercise price of options granted was equivalent to the market value of underlying stock at the grant date. Shares issued when options were exercised came from authorized but unissued shares. Due to the plan end date, there were no options available for grant as of December 31, 2014 or 2013.

No options were exercised or forfeited during 2014 or 2013. During 2013, all 4,042 oustanding options expired, and there were no remaining outstanding or exercisable options as of December 31, 2014 or 2013.

Note 10 - Income Taxes

Income tax expense consists of (000s omitted):

	2014	2013
Current expense	$ 30	$ 50
Deferred expense	757	1,080
Total income tax expense	$ 787	$ 1,130

Note 10 - Income Taxes (Continued)

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

	2014	2013
Deferred tax assets:		
Allowance for loan losses	$ 238	$ 613
Deferred compensation	1,140	1,180
Capital loss carryforward	340	1,144
Pension liability	763	710
Net operating loss	908	1,178
AMT tax credits	395	395
Unrealized losses on securities available for sale	-	255
Other	156	220
Total deferred tax assets	3,940	5,695
Deferred tax liabilities:		
Pension	(966)	(999)
Fixed assets	(226)	(251)
Mortgage servicing rights	(225)	(222)
Unrealized gains on securities available for sale	(201)	-
Accretion	(44)	(43)
Other	(36)	(37)
Total deferred tax liability	(1,698)	(1,552)
Net valuation allowance for capital losses	(340)	(1,144)
Net deferred tax asset	$ 1,902	$ 2,999

Net operating loss carryforwards of approximately $2.7 million will expire between 2031 and 2034.

During 2014, capital loss carryforwards of approximately $2.4 million expired, resulting in a decrease in a deferred tax asset and corresponding valuation allowance of $804,000.

Note 11 - 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 $777,000 and $1,052,000 at year end 2014 and 2013. Related party deposits totaled $8,314,000 and $4,561,000 at December 31, 2014 and 2013, respectively.

Note 12 - Commitments, Off-Balance Sheet Risk, and Contingencies

There are various contingent liabilities that are not reflected in the 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 year end 2014 and 2013, reserves of $0 and $1,958,000 were required as deposits with the Federal Reserve or as cash on hand. 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 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):

	2014	2013
Commitments to extend credit	$ 22,567	$ 19,350
Standby letters of credit	455	455

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

Note 13 - 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, 2014 and 2013 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 or liabilities 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 and liabilities 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 entirely 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 or liability.

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

Note 13 - Fair Value Measurements (Continued)

Securities classified as available for sale are generally reported at fair value utilizing Level 2 inputs where 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 13 - 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, 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
Collaterialized mortgage obligations	-	19,317	-	19,317
Total investment securities available for sale	$ -	$ 74,179	$ 18,927	$ 93,106

Note 13 - Fair Value Measurements (Continued)

Assets Measured at Fair Value on a Recurring Basis at December 31, 2013

	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, 2013
Assets				
Investment securities available for sale (000s omitted):				
U.S. Government and agency	$ -	$ 30,328	$ -	$ 30,328
Mortgage-backed	-	15,983	-	15,983
State and municipal	-	-	18,520	18,520
Auction rate securities	-	-	1,000	1,000
Collaterialized mortgage obligations	-	18,543	-	18,543
Total investment securities available for sale	$ -	$ 64,854	$ 19,520	$ 84,374

Changes in Level 3 assets measured at fair value on a recurring basis for the years ended December 31, 2013 and 2014 (000s omitted) are as follows:

	Investment Securities Available-for-sale
Balance at December 31, 2013	$ 19,520
Net purchases, sales, calls and maturities	(711)
Total realized gains	360
Total unrealized losses	(242)
Balance at December 31, 2014	$ 18,927

	Investment Securities Available-for-sale
Balance at January 1, 2013	$ 21,970
Net purchases, sales, calls and maturities	(2,227)
Total unrealized losses	(223)
Balance at December 31, 2013	$ 19,520

Note 13 - Fair Value Measurements (Continued)

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

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 non-recurring 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, 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

Assets Measured at Fair Value on a Nonrecurring Basis at December 31, 2013 (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, 2013
Assets				
Impaired loans	$ -	$ -	$ 4	$ 4

Note 14 - 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):

	2014		2013	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial Assets				
Cash and cash equivalents	$ 12,814	$ 12,814	$ 10,096	$ 10,096
Time deposits with other financial institutions	7,547	7,559	11,169	11,180
Securities available for sale	93,106	93,106	84,374	84,374
Securities held to maturity	6,529	6,756	5,726	6,014
Other securities	972	972	997	997
Loan held for sale	295	300	882	896
Loans, net	117,591	132,134	118,492	134,412
Accrued interest receivable on loans	419	419	368	368
Financial Liabilities				
Deposits	226,975	226,980	222,813	222,874
Accrued interest payable	12	12	13	13

Note 15 - Regulatory Capital

The Bank is subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings and other factors, and the regulators can lower classifications in certain cases. Failure to meet various capital requirements can initiate regulatory action that could have a direct material effect on the financial statements.

Note 15 - Regulatory Capital (Continued)

The prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required.

In 2013 the federal banking agencies issued revisions to the existing capital rules to incorporate certain changes to the Basel capital framework, including Basel III and other elements. The intent is to strengthen the definition of regulatory capital, increase risk-based capital requirements, and make selected changes to the calculation of risk-weighted assets. Beginning January 1, 2015, banks transitioned to the new rules and will report results with the first call report of 2015. As part of the new rules there are several provisions affecting the Company, such as the implementation of a new common tier ratio, the start of a capital conservation buffer, and increased prompt corrective action capital adequacy thresholds.

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, 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
As of December 31, 2013						
Total capital to Risk Weighted Assets:						
Bank	$ 22,400	17.0 %	$ 10,600	8.0 %	$ 13,200	10.0 %
Tier 1 capital to Risk Weighted Assets:						
Bank	20,800	15.7	5,300	4.0	7,900	6.0
Tier 1 capital to Average Assets:						
Bank	20,800	8.5	9,800	4.0	12,300	5.0

Note 15 - Regulatory Capital (Continued)

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. Under this calculation, allowable dividend payments during 2015 would be $3,793,000 plus 2015 net income, without prior regulatory approval.

OFFICERS OF CNB CORPORATION AND CITIZENS NATIONAL BANK

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PRESIDENT & CHIEF EXECUTIVE OFFICER
SHANNA L. HANLEY
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CREDIT MANAGER
VALERIE A JONES
RETAIL BANKING OFFICER
LINDSEY K. MILLER
BANKING OFFICER & BRANCH MANAGER
MICHELLE M MILLER
ASSISTANT BRANCH MANAGER

STAFF OF CITIZENS NATIONAL BANK

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Brandi Bedell
Kurt Blaskowski
Maghan Brooks
Bridget Brown
Laura Call
Kevin Chapman
Patricia Comps
Arlene Daniel
Matthew DeWildt
Mary Greenwood
Debra Grice
Kathleen Johnson
Carol A Kinder
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Sherri Kosan
Anne Labelle
Jill Lynch
Loretta Merchant
Penny Reynolds
Lee Sheets
Amy Socolovitch
M. Teresa Sullivan
Kathy Swackhamer
Lori Thornton
David Tomaski
Rebecca Tomaski
Sherry Wichlacz
Corinna Willis

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Susan Bliss
Sally Spray

SOUTH BRANCH CHEBOYGAN

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Pamela Kolasa
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Kathleen Robbins

INDIAN RIVER

Tiffany Llewellyn
Kelly Saker
Meagan Siecinski

ALANSON

Chandlar Kiogima
Amanda Nicholson
Memory Massey

GAYLORD

Debbie Altman

DIRECTORS OF CNB CORPORATION & CITIZENS NATIONAL BANK

VINCENT J. HILLESHEIM
Chairman
Retired President, Anchor In Marina of Northern Michigan, Inc.

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

THOMAS J. ELLENBERGER
Vice President & Secretary
Albert Ellenberger Lumber Company

SUSAN A. ENO
President & Chief Executive Officer, CNB Corporation
President & Chief Executive Officer, Citizens National Bank

KATHLEEN A. LIEDER
Retired, Partner, Bodman LLP

THOMAS J. REDMAN
President, Tube Fab

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President, Shepler's Mackinac Island Ferry Service

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

RICK A. TROMBLE
Owner, Tromble Bay Farms
Partner, Fernelius Ford

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Vice President Durocher Marine Division
Kokosing Construction Company, Inc.

DIRECTORS EMERITI

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KATHLEEN M. DARROW
THOMAS A. ELLENBERGER
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 922 shareholders as of December 31, 2014.

SHAREHOLDER RELATIONS AND ANNUAL REPORT AVAILABILITY

Beginning 2015, the Annual Report will not be mailed to each shareholder, but will be available as noted below.

Shareholders may obtain, without charge, a copy of the 2014 Annual Report at any time 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 19, 2015 at the Knights of Columbus Hall, 9840 N. Straits Highway, Cheboygan, Michigan, 49721 at 7:00 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 2014 and 2013.

	2014			2013		
	Market Price		Cash Dividends	Market Price		Cash Dividends
Quarter	High	Low	Declared	High	Low	Declared
1st	$12.45	$10.65	$0.10	$11.00	$ 9.55	$ -
2nd	13.00	11.95	0.10	12.00	10.50	-
3rd	14.00	12.50	-	12.50	10.35	0.10
4th	15.00	13.25	0.10	12.00	9.82	-