CHESAPEAKE
FINANCIAL SHARES INC.

2014 ANNUAL REPORT

2014 by the Numbers

Over
85
Organizations Served by Our **Volunteers**

130
Employees Volunteered

35 of those held officer positions

3,281
Small Businesses Served

Our customers rated our service **4.65** out of **5** based on 2014 surveys.

AMERICAN BANKER®

#11 in the nation of **Best Banks to Work For** according to *American Banker*

#28 in nation of **Top 200 Community Banks** based on three-year average ROE

Over
6,400
Volunteer Hours in 2014

$1.62 Earnings Per Share

10.37% Return on Equity

Over
20,000
Customers

First off, let me thank you for being a shareholder of Chesapeake Financial Shares. Through the last decade, with all of its ups and downs, we have continued to have consistently solid performance for our shareholders while being a cornerstone partner for each of the communities we serve. These are two of our core missions in our corporate mission statement.

The fundamentals of our local economy are showing slow but steady improvement. The continued artificially-induced low interest rate environment by the Federal Reserve makes core banking earnings difficult to realize. Our continued focus on earnings from sources other than traditional banking income is what has separated us from other banks and gives us a more stable income stream than many of our counterparts.

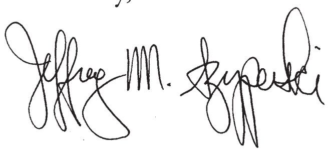
There were many passages in 2014 of those who have left their unique marks on our world: Maya Angelou, Louis Zamperini, Maria von Trapp, Shirley Temple Black, Robin Williams and Tom Magliozzi ("Car Talk"). We all leave footprints on this world, some are just more noticeable than others.

2014 earnings were $6,533,867, a decrease from last year's earnings. This is primarily attributable to a low-growth economy coupled with increased costs associated with regulatory compliance. Our return on equity of 10.37% still puts us as a top performing financial institution nationally. Our total assets remain level with year-end 2013.

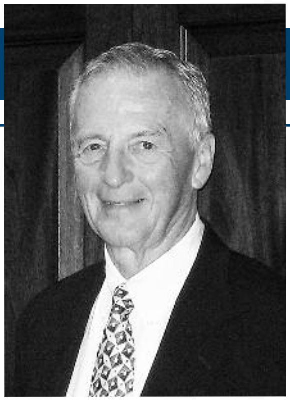
During 2014 we were recognized by *American Banker* magazine as one of the "Top 200 Community Banks" in the country for the seventh year in a row. Additionally, in a separate ranking, this same publication rated us as one of the "Best Banks to Work For" for the second consecutive year. We feel these two recognitions go hand in hand.

Organizationally, we believe we are well-positioned for growth going into 2015. Our symbiotic relationship with our communities continues to be one of our hallmarks. Please plan on joining us for our Annual Shareholders Meeting on Friday, April 3, at Rappahannock Westminster-Canterbury in Irvington. As usual, we want to make this both educational as well as entertaining. We look forward to seeing you there.

Sincerely,



Jeffrey M. Szyperski
Chairman, CEO & President
Chesapeake Financial Shares, Inc.



Thanks to Doug's committed leadership, Chesapeake Financial Shares is the great organization it is today, and the community it serves is a better place.

Douglas D. Monroe, Jr.

FIFTY YEARS OF SERVICE

In this year's Annual Report, we wish to recognize a significant milepost, Doug Monroe's 50th anniversary with Chesapeake Financial Shares! Our organization and the Northern Neck have been blessed by the various "marks" he has left along the way.

The old adage is, *"Leave things better than you find them."* Often this, when followed, is incremental. Doug has been able to do this in almost revolutionary ways since moving to the Northern Neck. As a founder of a local private school getting ready to celebrate its 50th anniversary (Chesapeake Academy); a founding organizer to the development of a thriving retirement community (Rappahannock Westminster-Canterbury); organizing member of a local hospital (Rappahannock General Hospital); and chair of the decade-long effort to establish a permanent "campus" for the Northern Neck Family YMCA, Northern Neck Free Health Clinic, River Counties Chapter of the Red Cross and RGH Rehabilitation Services & Sports Medicine Center (Virginia Quality Life, Inc.), he has truly left his mark. These are just the major efforts in which he has been on the front lines; his additional efforts are immeasurable.

Thanks to Doug's committed leadership, Chesapeake Financial Shares is the great organization it is today, and the community it serves is a better place. We are extremely proud to highlight these incredible achievements to pay tribute to the very modest man who has shaped our organization!

"We make a living by what we get, but we make a life by what we give." – Winston Churchill. Doug's life exemplifies this quote.

Chesapeake National Bank Board of Directors (1968)

Total Assets of the Bank as of December 31, 1964
$3,210,544

1964

1967

July 1967
President and CEO of Chesapeake National Bank

1969

1969 – 1971
Board of Directors, Federal Reserve Bank of Richmond

Boat Bank Office Christening – special guest "Miss Virginia," Cherie Suzanne Davis, and Doug Monroe

Kilmarnock new home of main office

January 2, 1965
Hired as EVP of Lancaster National Bank

1965

1968

1968 – 1998
Chesapeake Bank - President & CEO

CFS Directors Doug Monroe, Bill Shumadine and Nash Broaddus

Trust Department opened

1973

Trust Department Founders Tom Denegre and Doug Monroe

Civic and Professional Highlights

Doug Monroe presents Retired U.S. Army General Colin Powell with a gift at the 1998 VQL Community Center groundbreaking ceremony

MILITARY

- Lieutenant in the Naval Reserve – 1955-1959

BUSINESS AND PROFESSIONAL

- Commercial Banking and Financial Services – 1960 to present
- January 2, 1965, hired as EVP of Lancaster National Bank
- July 1967 – President and CEO of Chesapeake National Bank
- Chesapeake Bank – President & CEO – 1968-1998. Chairman of the Board of Directors 1977-2000. Chairman Emeritus 2001 to present
- 1969-1971 – Board of Directors, Federal Reserve Bank of Richmond
- Virginia Bankers Association – Board of Directors – 1978-1981. President – June 1991-1992 and served on various Committees 1970-1985
- Chesapeake Financial Shares, Inc. – Chairman of the Board of Directors & CEO – 1983-2007. Vice Chairman of the Board 2008 to present
- 1988-1999 – American Bankers Association Corporation for American Banking Board of Directors and served on various Councils 1981-1988

CIVIC AND SOCIAL

- Chesapeake Academy, Board of Directors and Chairman – 1965-1977 and 1999-2005. Member, Founding Board
- St. Margaret's School, Board of Directors – 1971-1977
- Rappahannock General Hospital, Board of Directors – Chairman of Finance Committee – Executive Committee – 1979-1998. Chairman of the Board of Directors – 1992-1998
- Rappahannock Westminster-Canterbury, Board of Directors – Secretary of corporation – 1980-1995. Member, Founding Board
- Foundation for Historic Christ Church, Chairman of Finance Committee – 1984-1987
- Chesapeake Health Services, Board of Directors – 1989-2015
- Northern Neck Free Health Clinic, Inc., Board of Directors and Finance Committee member – 1993-1997. Member, Founding Board
- Virginia Quality Life, Inc., Board of Directors and President – 1996-2008. Member, Founding Board. Chairman Emeritus – 2009
- Recognized as "Community Hero" in 2008 by River Counties Chapter of American Red Cross
- Northern Neck Food Bank, Board of Directors – 2012-2014
- Campbell Memorial Presbyterian Church, Past Deacon and Elder

1983

1983 – 2007
Chesapeake Financial Shares, Inc. – Chairman of the Board of Directors & CEO

1988

1988 – 1999
ABA Corporation for American Banking Board of Directors

2001 to present
Chesapeake Bank Chairman Emeritus

2001

Kit and Doug Monroe - 2013 Community Hero Dinner

1977

1977 – 2000
Chesapeake Bank – Chairman of the Board of Directors

CFS Directors Bob Lee Stephens, Jimmy Lewis, John Hunt and Doug Monroe (1990)

1991

June 1991 – 1992
President, Virginia Bankers Association

2008 to present
Chesapeake Financial Shares, Inc. – Vice Chairman of the Board of Directors

2008

2014

Total Assets of Chesapeake Financial Shares as of December 31, 2014
$663,186,230

	2014	2013	2012	2011	2010
	(Dollars in thousands except ratios and per share amounts)				
Results of Operations					
Interest income	$ 26,651	$ 27,415	$ 28,866	$ 29,779	$ 30,138
Interest expense	3,533	4,121	5,811	6,962	8,349
Net interest income	23,118	23,294	23,055	22,817	21,789
Provision for loan losses	600	1,133	600	1,190	2,487
Net interest income after provision for loan losses	22,518	22,161	22,455	21,627	19,302
Noninterest income	16,219	17,150	15,417	14,160	13,841
Noninterest expense	31,048	30,162	28,172	26,907	26,164
Income before tax	7,689	9,149	9,700	8,879	6,979
Income tax expense	1,155	1,796	2,024	1,898	1,533
Net income	$ 6,534	$ 7,353	$ 7,676	$ 6,981	$ 5,446
Financial Condition					
Total assets	$ 663,186	$ 662,992	$ 667,718	$ 637,953	$ 607,733
Total deposits	562,721	572,405	564,234	543,579	517,743
Net loans	385,304	374,275	366,878	349,287	356,505
Long-term debt	10,390	10,527	23,709	24,235	24,682
Trust preferred capital notes	10,310	15,465	15,465	15,465	15,465
Shareholders' equity	70,610	61,824	60,909	51,225	41,113
Average assets	661,669	655,170	643,079	619,905	602,473
Average shareholders' equity	62,981	56,790	51,612	45,463	40,179
Key Financial Ratios					
Return on average assets	0.99%	1.12%	1.19%	1.13%	0.90%
Return on average equity*	10.37%	12.95%	14.87%	15.30%	13.60%
Cash dividends paid as a percent of net income	27.41%	22.70%	19.33%	18.5%	21.6%
Per Share Data**					
Net income, assuming dilution	$ 1.620	$ 1.840	$ 1.930	$ 1.800	$ 1.410
Cash dividends declared	$ 0.45	$ 0.425	$ 0.375	$ 0.330	$ 0.298
Book value	$ 17.71	$ 18.76	$ 18.80	$ 15.67	$ 12.58

**Return on average equity is calculated by dividing net income by average equity for the period excluding accumulated other comprehensive income or loss and unearned ESOP shares.*

***All per share data has been restated to reflect the 2011 and 2014 stock splits.*

	December 31, 2014	December 31, 2013
Assets		
Cash and due from banks	$ 13,677,321	$ 13,094,678
Interest-bearing deposits in banks	12,987,575	46,790,629
Securities available for sale, at approximate fair value	190,299,243	164,440,957
Restricted stock, at cost	2,286,600	1,873,400
Loans held for sale	150,000	—
Loans, net of allowance for loan losses of $6,365,886 in 2014 and $6,323,904 in 2013	385,304,316	374,274,792
Premises and equipment, net	17,256,039	15,696,699
Accrued interest receivable	2,922,375	2,737,853
Cash management accounts, net of allowance of $1,347,864 in 2014 and $685,137 in 2013	17,185,969	19,720,572
Foreclosed assets, net of allowance of $822,629 in 2014 and $832,981 in 2013	2,701,337	4,015,313
Bank-owned life insurance	10,764,759	10,456,601
Other assets	7,650,696	9,890,339
Total assets	$ 663,186,230	$ 662,991,833
Liabilities and Shareholders' Equity		
Deposits:		
Demand accounts	$ 126,017,403	$ 118,876,325
Savings and interest-bearing demand deposits	248,007,401	236,434,565
Certificates of deposit		
Denominations less than $250,000	166,035,241	180,269,027
Denominations of $250,000 or more	22,661,059	36,825,246
Total deposits	$ 562,721,104	$ 572,405,163
Trust preferred capital notes	10,310,000	15,465,000
Long-term debt	10,390,339	10,527,460
Accrued interest payable	148,264	183,897
Accrued expenses and other liabilities	9,006,946	2,586,290
Commitments and contingencies	—	—
Total liabilities	$ 592,576,653	$ 601,167,810
Shareholders' equity:		
Preferred stock, par value $1 per share; authorized 50,000 shares; no shares outstanding	$ —	$ —
Common stock, voting, par value $5 per share; authorized 4,800,000 shares; issued and outstanding 3,985,926 in 2014 and 3,296,233 in 2013 (including 49,380 2014 and 26,450 2013 nonvested shares)	19,682,730	16,348,915
Common stock, nonvoting, par value $5 per share; authorized 635,000 shares; no shares outstanding	—	—
Additional paid-in capital	389,534	145,903
Retained earnings	44,468,303	43,139,881
Unearned ESOP shares	(138,400)	(276,800)
Accumulated other comprehensive income	6,207,410	2,466,124
Total shareholders' equity	$ 70,609,577	$ 61,824,023
Total liabilities and shareholders' equity	$ 663,186,230	$ 662,991,833

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

CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31, 2014	2013
Interest and Dividend Income		
Interest and fees on loans	$ 20,491,697	$ 21,079,462
Interest on interest-bearing deposits and federal funds sold	17,938	31,328
Interest and dividends on securities available for sale:		
Taxable	2,127,963	2,614,652
Nontaxable	3,927,903	3,632,451
Dividends	85,048	57,201
Total interest and dividend income	$ 26,650,549	$ 27,415,094
Interest Expense		
Savings and interest-bearing accounts	$ 594,445	$ 668,297
Certificates of deposit	2,335,862	2,750,044
Short-term borrowings and FHLB advances	340,373	408,341
Long-term debt and trust preferred capital notes	262,790	294,518
Total interest expense	$ 3,533,470	$ 4,121,200
Net interest income	$ 23,117,079	$ 23,293,894
Provision for loan losses	600,000	1,133,336
Net interest income after provision for loan losses	$ 22,517,079	$ 22,160,558
Noninterest Income		
Trust income	$ 2,280,020	$ 1,996,982
Service charges	1,148,539	1,250,781
Net gain on sales of securities available for sale	176,673	952,682
Net other-than-temporary impairment losses on investments recognized in earnings (includes total other-than-temporary impairment losses of $435,219 and $639,899, net of $66,019 and $64,046 recognized in other comprehensive income before taxes)	(369,200)	(575,853)
Other income	12,983,434	13,525,648
Total noninterest income	$ 16,219,466	$ 17,150,240
Noninterest Expenses		
Salaries and benefits	$ 14,587,482	$ 14,138,358
Occupancy expenses	3,360,242	3,381,603
Net loss on other real estate owned	534,935	379,011
Other expenses	12,565,434	12,262,617
Total noninterest expenses	$ 31,048,093	$ 30,161,589
Income before income taxes	$ 7,688,452	$ 9,149,209
Income tax expense	1,154,585	1,796,156
Net income	$ 6,533,867	$ 7,353,053
Earnings per common share, basic	$ 1.65	$ 1.90
Earnings per common share, diluted	$ 1.62	$ 1.84

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

	Years Ended December 31,	
	2014	**2013**
Net income	$ 6,533,867	$ 7,353,053
Other comprehensive income (loss):		
Unrealized holding gains (losses) on securities available for sale, net of tax expense (benefit) of $1,861,870 and ($2,479,095)	$ 3,614,218	$ (4,812,361)
Reclassification adjustment, net of income tax expense (benefit) of ($65,459) and $128,122	127,068	(248,707)
Other comprehensive income (loss), net of tax	$ 3,741,286	$ (5,061,068)
Comprehensive income	$ 10,275,153	$ 2,291,985

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

	Years Ended December 31, 2014	2013
Cash Flows from Operating Activities		
Net income	$ 6,533,867	$ 7,353,053
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,619,436	1,689,143
Provision for loan losses	600,000	1,133,336
Provision for cash management account losses	550,000	742,666
Deferred income tax expense (benefit)	(653,142)	951,140
Amortization of premiums, net	1,589,029	1,165,656
Net (gain) on securities available for sale	(176,673)	(952,682)
Gain on redemption of trust preferred capital note	(1,100,000)	—
Net other-than-temporary impairment losses	369,200	575,853
Net loss on other real estate owned	534,935	379,011
Stock-based compensation	259,874	134,774
Release of ESOP shares	218,419	216,788
Origination of loans available for sale	(15,261,635)	(47,576,715)
Proceeds from sale of loans available for sale	15,111,635	49,398,515
Issuance of common stock for services	90,423	99,333
Changes in other assets and liabilities:		
(Increase) in accrued interest receivable	(184,522)	111,588
Decrease (increase) in other assets	2,405,119	(674,363)
(Decrease) in accrued interest payable	(35,633)	(29,931)
Increase (decrease) in other liabilities	6,420,656	(600,666)
Net cash provided by operating activities	$ 18,890,988	$ 14,116,499
Cash Flows from Investing Activities		
Purchases of securities available for sale	$ (47,633,141)	$ (35,301,784)
Proceeds from sales and calls of securities available for sale	6,276,852	12,143,850
Proceeds from maturities of securities available for sale	18,679,684	29,948,200
(Purchase) redemption of restricted stock, net	(413,200)	717,600
Proceeds from sale of other real estate	1,705,153	808,154
Net (increase) in loans	(12,555,636)	(9,341,349)
Net decrease in cash management accounts	1,984,603	911,007
Other capital expenditures	(3,121,219)	(1,419,957)
Net cash (used in) investing activities	$ (35,076,904)	$ (1,534,279)

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

	Years Ended December 31, 2014	2013
Cash Flows from Financing Activities		
Net increase in demand accounts, interest-bearing demand accounts and savings accounts	$ 18,713,914	$ 3,548,664
Net increase (decrease) in certificates of deposits	(28,397,973)	4,622,544
Exercise of stock options	333,985	979,003
Repurchase of common stock	(601,512)	(1,137,819)
Cash dividends	(1,790,788)	(1,668,984)
Curtailment of long-term debt	(5,292,121)	(13,181,620)
Net cash (used in) financing activities	$ (17,034,495)	$ (6,838,212)
Net (decrease) increase in cash and cash equivalents	$ (33,220,411)	$ 5,744,008
Cash and cash equivalents at beginning of year	59,885,307	54,141,299
Cash and cash equivalents at end of year	$ 26,664,896	$ 59,885,307
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for:		
Interest	$ 3,569,103	$ 4,151,131
Income taxes	$ 684,377	$ 2,065,500
Supplemental Schedule of Noncash Investing and Financing Activities		
Unrealized gain (loss) on securities available for sale	$ 5,668,615	$ (7,668,285)
Other real estate acquired in settlement of loans	$ 926,112	$ 811,089

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

Years Ended December 31, 2014 and 2013

	Common Stock, Voting	Additional Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income	Total
Balance, December 31, 2012	$ 16,196,850	$ —	$ 37,600,101	$ (415,200)	$ 7,527,192	$ 60,908,943
Net income	—	—	7,353,053	—	—	7,353,053
Other comprehensive income (loss)	—	—	—	—	(5,061,068)	(5,061,068)
Exercise of stock options	443,880	535,123	—	—	—	979,003
Release of ESOP shares	—	—	78,388	138,400	—	216,788
Issuance of common stock for services	29,130	—	70,203	—	—	99,333
Repurchase of common stock	(320,945)	(457,990)	(358,884)	—	—	(1,137,819)
Amortization of Restricted Stock	—	68,770	—	—	—	68,770
Stock-based compensation	—	—	66,004	—	—	66,004
Cash dividends ($0.425 per share)	—	—	(1,668,984)	—	—	(1,668,984)
Balance, December 31, 2013	$ 16,348,915	$ 145,903	$ 43,139,881	$ (276,800)	$ 2,466,124	$ 61,824,023
Net income	—	—	6,533,867	—	—	6,533,867
Other comprehensive income	—	—	—	—	3,741,286	3,741,286
Exercise of stock options	153,475	180,510	—	—	—	333,985
Vesting of Restricted Stock	42,395	(42,395)	—	—	—	—
Release of ESOP shares	—	80,019	—	138,400	—	218,419
Issuance of common stock for services	31,310	59,113	—	—	—	90,423
Repurchase of common stock	(173,190)	(428,322)	—	—	—	(601,512)
Amortization of Restricted Stock	—	222,778	—	—	—	222,778
Stock-based compensation	—	37,096	—	—	—	37,096
Effect of stock split	3,279,825	134,832	(3,414,657)	—	—	—
Cash dividends ($0.45 per share)	—	—	(1,790,788)	—	—	(1,790,788)
Balance, December 31, 2014	$ 19,682,730	$ 389,534	$ 44,468,303	$ (138,400)	$ 6,207,410	$ 70,609,577

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

Note 1. Summary of Significant Accounting Policies

General

Chesapeake Financial Shares, Inc. ("CFS" or "Company") owns 100% of Chesapeake Bank (the "Bank"), Chesapeake Investment Group, Inc. ("CIG"), and CFS Capital Trust (the "Trusts"). Three additional companies, Chesapeake Financial Group, Inc., Chesapeake Insurance Agency, Inc. T/A Chesapeake Investment Services and Chesapeake Trust Company (the "Trust Company") are wholly-owned subsidiaries of CIG. The consolidated financial statements include the accounts of CFS and its wholly-owned subsidiaries. All significant intercompany accounts have been eliminated.

Subsequent Events

Subsequent events have been considered through February 16, 2015, the same date on which these consolidated financial statements were issued.

Significant Accounting Policies

The accounting and reporting policies of CFS are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. The more significant of these policies are summarized below.

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as "held to maturity" and recorded at amortized cost. Trading securities are recorded at fair value with changes in fair value included in earnings. Securities not classified as held to maturity or trading, including equity securities with readily determinable fair values, are classified as "available for sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method. CFS classifies all securities as available for sale.

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (a) the intent is to sell the security or (b) it is more-likely-than-not that it will be necessary to sell the security prior to recovery of its amortized cost. If, however, management's intent is not to sell the security and it is not more than likely that management will be required to sell the security before recovery, management must determine what portion of the impairment is attributable to credit loss, which occurs when the amortized cost of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income. For equity securities carried at cost as restricted stock, impairment is considered to be other-than-temporary based on CFS's ability and intent to hold the investment until a recovery of fair value. Other-than-temporary impairment of an equity security results in a write-down that must be included in income. Management regularly reviews each security for other-than-temporary impairment based on criteria that includes the extent to which cost exceeds market price, the duration of that market decline, the financial health of and specific prospects for the issuer, the best estimate of the present value of cash flows expected to be collected from debt securities, the intention with regards to holding the security to maturity and the likelihood that CFS would be required to sell the security before recovery.

Loans

The Bank grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans and commercial real estate throughout the Northern Neck, Middle Peninsula, Williamsburg, James City County, and Richmond areas of Virginia. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate and general economic conditions in these areas.

The Bank's recorded investments in loans are stated at face value, net of unearned discount and the allowance for loan losses. Interest is computed by methods which result in level rates of return on principal. Nonrefundable loan fees and direct loan origination costs are recognized in operations when received and incurred. The impact of this methodology is not significantly different from recognizing the net of the fees and costs over the contractual life of the related loan.

The Bank analyzes its loan portfolio by segment. Segments are based on the level at which the allowance for loan losses is calculated and monitored. The Bank's loan segments are commercial – non real estate, commercial – real estate, consumer – non real estate, and residential – real estate. The Bank further segregates each segment of the loan portfolio into classes based on how each loan was initially recorded. Classes are a level of detail that appropriately exhibits the risks inherent in the loan portfolio.

The loan portfolio is segmented based on risk characteristics. Particular characteristics associated with each segment are detailed below:

Residential – Real Estate: Consumer real estate loans carry risks associated with the continued creditworthiness of the borrower and changes in the value of the collateral.

Consumer – Non Real Estate: Consumer non real estate loans carry risks associated with the continued creditworthiness of the borrower and the value of the collateral, such as automobiles which may depreciate more rapidly than other assets. In addition, these loans may be unsecured. Consumer loans are more likely than real estate loans to be immediately affected in an adverse manner by job loss, divorce, illness or personal bankruptcy.

Commercial – Non Real Estate: Commercial loans not secured by real estate carry risks associated with the successful operation of a business, and the repayments of these loans depend on the profitability and cash flows of the business. Additional risk relates to the value of collateral where depreciation occurs and the valuation is less precise.

Commercial – Real Estate: Loans secured by commercial real estate also carry risks associated with the success of the business and ability to generate a positive cash flow sufficient to service debts. Real estate security diminishes risks only to the extent that a market exists for the subject collateral. Some real estate secured construction loans carry risks that a project will not be completed as scheduled and budgeted and that the value of the collateral may, at any point, be less than the principal amount of the loan.

Loans of each class are placed on nonaccrual status when a loan is specifically determined to be impaired or when principal or interest is delinquent for 90 days or more. Any unpaid interest previously accrued on those loans is reversed from income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are applied as a reduction of the loan principal balance. Generally, the Bank will return a loan to accrual status when all delinquent interest and principal becomes current and remains current for six consecutive months under the terms of the loan agreement or the loan is well-secured and in the process of collection.

Mortgage loans held for resale are stated at the lower of cost or market on an individual loan basis. Loan discounts and origination fees received on loans held for resale are deferred until the related loans are sold to third party investors. Gains are recognized at the time of sale.

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. Loans of each segment are fully or partially charged off against the allowance when the Bank deems the amount to be uncollectible. General conditions for charge-off include repayment schedules that are deemed to be protracted beyond a reasonable timeframe, the loan has been classified as a loss either internally or by regulators, or the loan is 180 days past due unless well-secured and in the process of collection. 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 allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price less costs to liquidate) of the impaired loan are lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical charge-off by segment and expected default derived from CFS's loss experience by loan type. Other adjustments may be made to the allowance based on an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data. Adjustments to the historical charge-off factors are made for each segment based on management's assessment of the state of the economy, delinquencies, exceptions to loan underwriting/monitoring policies, and local unemployment. There were no significant changes to the Bank's allowance methodology during the current year.

A loan in each class is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral.

Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower's financial condition, management may grant a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). Management strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before the loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using both straight-line and accelerated methods over the assets' estimated useful lives. Estimated useful lives range from 10 to 39 years for buildings and 3 to 7 years for furniture, fixtures and equipment.

Foreclosed Assets

Foreclosed assets are recorded at the time of foreclosure at their fair value net of estimated costs to sell. At foreclosure, any excess of the loan balance over the fair value of the property is charged to the allowance for loan losses. Such carrying value is periodically reevaluated and written down as a direct expense if there is an indicated decline in fair value. Costs to bring a property to salable condition are capitalized up to the fair value of the property, while costs to maintain a property in salable condition are expensed as incurred.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (a) the assets have been isolated from CFS – put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (b) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (c) CFS does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Income Taxes

The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying provisions of the enacted tax law to the taxable income or excess deductions over revenues. CFS determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more-likely-than-not, based on the technical merits, that the tax position will be realized or sustained under examination. The term more-likely-than-not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of the evidence available, it is more-likely-than-not that some portion or all of a deferred tax asset will not be realized.

CFS accounts for income taxes in accordance with the accounting guidance related to uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions.

Consolidated Statements of Cash Flows

For purposes of the consolidated statement of cash flows, CFS considers cash equivalents to include cash on hand, amounts due from banks and federal funds sold.

Advertising Costs

CFS follows the policy of charging the production costs of advertising to expense as incurred.

Use of Estimates

In preparing 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 deferred tax assets, other-than-temporary impairments of securities, and the valuation of foreclosed assets.

Stock Split

On July 18, 2014, the Board of Directors approved a 6-for-5 stock split of CFS's common stock payable on or before October 15, 2014. All per share information for all periods presented has been retroactively restated to reflect the stock split.

Earnings Per Common Share

Basic earnings per common share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per common 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. Potential common shares that may be issued by CFS relate solely to outstanding stock options and are determined using the treasury stock method.

Cash Management Accounts

CFS purchases trade accounts receivable from customers. These receivables are stated at face value net of discounts and an allowance for losses. CFS retains reserves against these customer balances in a separate liability account on the general ledger to cover unpaid receivables, returns, allowances and other adjustments.

Share-Based Compensation

Share-based compensation accounting requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The share compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, and performance-based awards.

The share-based compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. Compensation cost is recognized on a straight-line basis over the requisite service period for the award. A Black-Scholes model is used to estimate the fair value of stock options, while the Company's common stock at the date of grant is used for restricted awards. There were no options granted in 2014.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully discussed in Note 16. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions significantly affect the estimates.

Trust Company Assets

Securities and other property held by the Trust Company in a fiduciary or agency capacity are not assets of CFS and are not included in the accompanying consolidated financial statements.

Recent Accounting Pronouncements

In January 2014, the FASB issued ASU 2014-01, "Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (a consensus of the FASB Emerging Issues Task Force)." The amendments in this ASU permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this ASU should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this ASU are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. CFS is currently assessing the impact that ASU 2014-01 will have on its consolidated financial statements.

In January 2014, the FASB issued ASU 2014-04, "Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force)." The amendments in this ASU clarify that an in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. CFS is currently assessing the impact that ASU 2014-04 will have on its consolidated financial statements.

In April 2014, the FASB issued ASU 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity." The amendments in this ASU change the criteria for reporting discontinued operations while enhancing disclosures in this area. Under the new guidance, only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization's operations and financial results and include disposals of a major geographic area, a major line of business, or a major equity method investment. The new guidance requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. Additionally, the new guidance requires disclosure of the pre-tax income attributable to a disposal of a significant part of an organization that does not qualify for discontinued operations reporting. The amendments in the ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. CFS does not expect the adoption of ASU 2014-08 to have a material impact on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers: Topic 606." This ASU applies to any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards. The guidance supersedes the revenue recognition requirements in Topic 605, "Revenue Recognition," most industry-specific guidance, and some cost guidance included in Subtopic 605-35, "Revenue Recognition—Construction-Type and Production-Type Contracts." The core principle of the guidance is that an entity should recognize 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. To be in alignment with the core principle, an entity must apply a five step process including: identification of the contract(s) with a customer, identification of performance obligations in the contract(s), determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue when (or as) the entity satisfies a performance obligation. Additionally, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer have also been amended to be consistent with the guidance on recognition and measurement. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. CFS is currently assessing the impact that ASU 2014-09 will have on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." This ASU aligns the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. The new guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be accounted for on a combined basis as a forward agreement. The amendments in the ASU also require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. Additional disclosures will be required for the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The amendments in this ASU are effective for the first interim or annual period beginning after December 15, 2014; however, the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early adoption is not permitted. CFS is currently assessing the impact that ASU 2014-11 will have on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." The new guidance applies to reporting entities that grant employees share-based payments in which the terms of the award allow a performance target to be achieved after the requisite service period. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. Existing guidance in "Compensation – Stock Compensation (Topic 718)," should be applied to account for these types of awards. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Early adoption is permitted and reporting entities may choose to apply the amendments in the ASU either on a prospective or retrospective basis. CFS is currently assessing the impact that ASU 2014-12 will have on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-14, "Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure." The amendments in this ASU apply to creditors that hold government-guaranteed mortgage loans and are intended to eliminate the diversity in practice related to the classification of these guaranteed loans upon foreclosure. The new guidance stipulates that a mortgage loan be derecognized and a separate other receivable be recognized upon foreclosure if (1) the loan has a government guarantee that is not separable from the loan prior to foreclosure, (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim, and (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. Upon foreclosure, the other receivable should be measured on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2014. Entities may adopt the amendments on a prospective basis or modified retrospective basis as of the beginning of the annual period of adoption; however, the entity must apply the same method of transition as elected under ASU 2014-04. Early adoption is permitted provided the entity has already adopted ASU 2014-04. CFS is currently assessing the impact that ASU 2014-14 will have on its consolidated financial statements.

In November 2014, the FASB issued ASU No. 2014-16, "Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity." The amendments in this ASU do not change the current criteria in U.S. GAAP for determining when separation of certain embedded derivative features in a hybrid financial instrument is required. The amendments clarify how current U.S. GAAP should be interpreted in evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Specifically, the amendments clarify that an entity should consider all relevant terms and features, including the embedded derivative feature being evaluated for bifurcation, in evaluating the nature of the host contract. Furthermore, the amendments clarify that no single term or feature would necessarily determine the economic characteristics and risks of the host contract. Rather, the nature of the host contract depends upon the economic characteristics and risks of the entire hybrid financial instrument. The amendments in this ASU also clarify that, in evaluating the nature of a host contract, an entity should assess the substance of the relevant terms and features (i.e., the relative strength of the debt-like or equity-like terms and features given the facts and circumstances) when considering how to weight those terms and features. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption, including adoption in an interim period, is permitted. CFS does not expect the adoption of ASU 2014-16 to have a material impact on its consolidated financial statements.

In January 2015, the FASB issued ASU No. 2015-01, "Income Statement—Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items." The amendments in this ASU eliminate from U.S. GAAP the concept of extraordinary items. Subtopic 225-20, Income Statement - Extraordinary and Unusual Items, required that an entity separately classify, present, and disclose extraordinary events and transactions. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. If an event or transaction meets the criteria for extraordinary classification, an entity is required to segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. The entity also is required to disclose applicable income taxes and either present or disclose earnings-per-share data applicable to the extraordinary item. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. CFS does not expect the adoption of ASU 2015-01 to have a material impact on its consolidated financial statements.

Note 2. Securities

Amortized cost and fair values of securities available for sale as of December 31, 2014 and 2013, are as follows:

2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Securities of state and political subdivisions	$ 114,454,446	$ 8,236,672	$ (158,546)	$ 122,532,572
Mortgage-backed securities	66,439,627	2,078,433	(751,389)	67,766,671
Total	$ 180,894,073	$ 10,315,105	$ (909,935)	$ 190,299,243

2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Securities of state and political subdivisions	$ 103,785,800	$ 4,159,319	$ (1,324,760)	$ 106,620,359
Mortgage-backed securities	56,918,602	1,953,392	(1,051,396)	57,820,598
Total	$ 160,704,402	$ 6,112,711	$ (2,376,156)	$ 164,440,957

The amortized cost and fair value of securities available for sale as of December 31, 2014, by contractual maturity are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations without penalties.

	Amortized Cost	Fair Value
Due in one year or less	$ 10,858,677	$ 11,164,668
Due after one year through five years	99,386,791	105,420,014
Due after five years through ten years	62,773,074	65,257,212
Due after ten years	7,875,531	8,457,349
Total	$ 180,894,073	$ 190,299,243

Proceeds from sales and calls of securities available for sale during 2014 and 2013 were $6,276,852 and $12,143,850, respectively. Gross realized gains amounted to $176,673 and $1,355,085 in 2014 and 2013. Gross realized losses amounted to $0 and $402,403 in 2014 and 2013. The tax provision applicable to these net realized gains amounted to $60,069 and $323,912 in 2014 and 2013, respectively.

The amortized cost of securities pledged to secure public deposits, borrowings from the Federal Home Loan Bank, fiduciary powers and for other purposes required or permitted by law amounted to $82,161,174 and $89,324,451 at December 31, 2014 and 2013, respectively.

Temporarily Impaired Securities

Information pertaining to securities with gross unrealized losses at December 31, 2014 and 2013, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	2014			
	Less Than 12 Months		12 Months or More	
	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)
Securities of state and political subdivisions	$ 2,293,196	$ (12,262)	$ 2,859,220	$ (146,284)
Mortgage-backed securities	16,524,573	(196,140)	8,707,147	(555,249)
	$ 18,817,769	$ (208,402)	$ 11,566,367	$ (701,533)

	2013			
	Less Than 12 Months		12 Months or More	
	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)
Securities of state and political subdivisions	$ 23,469,721	$ (688,428)	$ 4,298,304	$ (636,332)
Mortgage-backed securities	13,951,101	(261,113)	6,738,742	(790,283)
	$ 37,420,822	$ (949,541)	$ 11,037,046	$ (1,426,615)

Securities of State and Political Subdivisions

CFS's unrealized losses on investments in 7 municipal bonds relate to investments in longer-term securities of municipalities throughout the U.S. The unrealized losses are primarily caused by the trend in interest rates. CFS currently does not believe it is probable that it will be unable to collect all amounts due according to the contractual terms of the investments. Because CFS does not intend to sell the investments and it is not more-likely-than-not that CFS will be required to sell the investments before recovery of its par value, which may be maturity, it does not consider these investments to be other-than-temporarily impaired at December 31, 2014.

Mortgage-Backed Securities

The unrealized losses on CFS's investment in 10 government-sponsored enterprise mortgage-backed securities were caused by interest rate movements. CFS purchased those investments at a premium relative to their face amount, and the contractual cash flows of those investments are guaranteed by an agency of the U.S. government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of CFS's investments. Because the decline in the market value is attributable to changes in interest rates and not credit quality, and because CFS does not intend to sell the investments and it is not more-likely-than-not that CFS will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, CFS does not consider those investments to be other-than-temporarily impaired at December 31, 2014.

The unrealized losses associated with 18 private residential mortgage-backed securities are primarily driven by higher projected collateral losses, wider credit spreads and changes in interest rates. CFS assessed credit impairment using an economic cash flow model. Based upon the Company's assessment of the expected credit losses of the security given the performance of the underlying collateral, we have appropriately recognized the related other-than-temporary impairment losses in private residential mortgage-backed securities. The remaining unrealized losses are deemed to be related to factors other than credit.

Management continuously monitors the mortgage-backed securities portfolio for potential permanent impairment. Analytical tools used include robust credit risk analysis. CFS strives to maintain exposure only to securities that have credit support in excess of original issue levels. Generally, it is CFS's intent to hold the securities for the time necessary to recover the amortized cost unless prudent business decisions warrant otherwise.

Other-Than-Temporary Impairment

CFS routinely conducts periodic reviews to identify and evaluate each investment security to determine whether an other-than-temporary impairment (OTTI) has occurred. The initial indicator of OTTI is a decline in market value (unrealized loss) below the amount recorded for an investment as well as the severity and duration of the decline. If the decline in fair value is below amortized cost, CFS recognizes OTTI if (1) CFS has the intent to sell the security, (2) it is more-likely-than-not that CFS will be required to sell the security before recovery of its amortized cost basis, or (3) CFS does not expect to recover the entire amortized cost of the security. While all securities are considered, the securities primarily impacted by OTTI analysis are private residential mortgage-backed securities. CFS uses economic models to aid in its determination of OTTI. Various inputs into the economic models are used to determine if OTTI exists. The most significant inputs in determining OTTI are:

- Length of time and extent to which fair value has been less than amortized cost,
- Cause of the decline, such as interest rates or adverse conditions in the market,
- Payment structure of the security,
- Credit performance of the underlying collateral, including delinquency rates, nonperforming collateral/defaults, severities of losses, collateral values and expected credit losses,
- Current rating of security, and
- Independent analysts' reports and forecasts.

Other inputs may include the actual collateral attributes and other performance indicators of the underlying asset.

If CFS determines that a given security is subject to OTTI write-down or loss, CFS records the expected credit portion loss as a charge to earnings. The measurement of the credit loss component is equal to the difference between the security's cost basis and the present value of its expected future cash flows, using the economic models, discounted at the security's purchase yield assumption. The remaining non-credit portion is recorded in other comprehensive income.

The following roll forward reflects the amount related to possible credit losses recognized in earnings. The beginning balance represents possible credit losses on debt securities at the beginning of the period for which a portion of an other-than-temporary impairment was recognized in other comprehensive income.

	Available for Sale
Beginning balance as of December 31, 2013	$ 2,413,605
Amount related to the credit loss for which an other-than-temporary impairment was not previously recognized	369,200
Realized losses	—
Ending balance as of December 31, 2014	$ 2,782,805

Note 3. Loans

A summary of the balances of loans by segment follows:

	December 31, 2014	December 31, 2013
Commercial - Non Real Estate	$ 120,918,745	$ 124,386,024
Commercial - Real Estate	174,767,809	163,842,463
Residential - Real Estate	84,856,732	82,158,078
Consumer - Non Real Estate	11,126,916	10,212,131
	$ 391,670,202	$ 380,598,696
Less: Allowance for loan losses	6,365,886	6,323,904
Loans, net	$ 385,304,316	$ 374,274,792

Overdrafts totaling $180,904 and $44,748 at December 31, 2014 and 2013, respectively, were reclassified from deposits to loans.

An analysis of the allowance for loan losses by segment follows:

	Commercial - Non Real Estate	Commercial - Real Estate	Consumer - Non Real Estate	Residential - Real Estate	Unallocated	Total
Year Ended December 31, 2014						
Balance beginning of year	$ 2,572,390	$ 1,403,405	$ 291,617	$ 1,802,606	$ 253,886	$ 6,323,904
Provision for loan losses	550,857	272,801	357,850	(327,622)	(253,886)	600,000
Loans charged off	(98,497)	—	(346,704)	(230,629)	—	(675,830)
Recoveries on loans previously charged off	—	—	8,474	109,338	—	117,812
Total allowance for loan losses	$ 3,024,750	$ 1,676,206	$ 311,237	$ 1,353,693	$ —	$ 6,365,886
Individually evaluated for impairment	$ 1,717,076	$ 667,988	$ 81,440	$ 409,967	$ —	$ 2,876,471
Collectively evaluated for impairment	1,307,674	1,008,218	229,797	943,726	—	3,489,415
Total allowance for loan losses	$ 3,024,750	$ 1,676,206	$ 311,237	$ 1,353,693	$ —	$ 6,365,886
Individually evaluated for impairment	$ 7,630,170	$ 7,758,574	$ 150,102	$ 1,598,699	$ —	$ 17,137,545
Collectively evaluated for impairment	113,288,575	167,009,235	10,976,814	83,258,033	—	374,532,657
Total loans	$ 120,918,745	$ 174,767,809	$ 11,126,916	$ 84,856,732	$ —	$ 391,670,202

	Commercial - Non Real Estate	Commercial - Real Estate	Consumer - Non Real Estate	Residential - Real Estate	Unallocated	Total
Year Ended December 31, 2013						
Balance beginning of year	$ 2,367,964	$ 1,964,488	$ 354,247	$ 1,412,408	$ 252,682	$ 6,351,789
Provision for loan losses	320,775	(561,083)	(50,237)	1,422,677	1,204	1,133,336
Loans charged off	(116,470)	—	(21,793)	(1,033,793)	—	(1,172,056)
Recoveries on loans previously charged off	121	—	9,400	1,314	—	10,835
Total allowance for loan losses	$ 2,572,390	$ 1,403,405	$ 291,617	$ 1,802,606	$ 253,886	$ 6,323,904
Individually evaluated for impairment	$ 1,326,045	$ 308,314	$ 128,947	$ 611,526	$ —	$ 2,374,832
Collectively evaluated for impairment	1,246,345	1,095,091	162,670	1,191,080	253,886	3,949,072
Total allowance for loan losses	$ 2,572,390	$ 1,403,405	$ 291,617	$ 1,802,606	$ 253,886	$ 6,323,904
Individually evaluated for impairment	$ 12,839,283	$ 11,092,523	$ 292,203	$ 3,468,780	$ —	$ 27,692,789
Collectively evaluated for impairment	111,546,741	152,749,940	9,919,928	78,689,298	—	352,905,907
Total loans	$ 124,386,024	$ 163,842,463	$ 10,212,131	$ 82,158,078	$ —	$ 380,598,696

The following is a summary of information pertaining to impaired loans by class at December 31, 2014 and 2013:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2014					
With no related allowance:					
Commercial - Non Real Estate					
Secured	$ 473,141	$ 473,141	$ —	$ 946,384	$ 38,327
Unsecured	—	—	—	—	—
Commercial - Real Estate					
Acquisition and development	453,726	453,726	—	429,481	27,597
Non-owner occupied	—	—	—	—	—
Owner occupied	962,126	962,126	—	732,893	58,867
Multifamily	—	—	—	—	—
Consumer - Non Real Estate					
Installment	40,242	40,242	—	44,602	6,072
Revolving	1,000	1,000	—	710	226
Other	—	—	—	—	—
Residential - Real Estate					
First Lien 1-4 Family	657,675	657,675	—	672,047	43,187
Junior Lien 1-4 Family	15,181	15,181	—	10,199	278
Construction	—	—	—	—	—
Land	41,025	41,025	—	77,953	2,113
Revolving	321,908	321,908	—	393,909	22,178
With an allowance recorded:					
Commercial - Non Real Estate					
Secured	$ 6,870,020	$ 6,870,020	$ 1,449,292	$ 7,951,558	$ 511,863
Unsecured	287,009	287,009	267,784	341,135	16,257
Commercial - Real Estate					
Acquisition and development	—	—	—	39,480	—
Non-owner occupied	5,453,371	5,453,371	499,216	2,136,897	252,447
Owner occupied	889,351	889,351	168,772	569,088	55,364
Multifamily	—	—	—	—	—
Consumer - Non Real Estate					
Installment	105,666	105,666	78,246	121,433	6,239
Revolving	3,194	3,194	3,194	3,073	244
Other	—	—	—	—	—
Residential - Real Estate					
First Lien 1-4 Family	96,241	96,241	18,942	122,339	7,595
Junior Lien 1-4 Family	—	—	—	85,816	—
Construction	—	—	—	—	—
Land	16,344	16,344	11,200	67,061	1,148
Revolving	450,325	450,325	379,825	471,249	7,354
Total:					
Commercial - Non Real Estate	$ 7,630,170	$ 7,630,170	$ 1,717,076	$ 9,239,077	$ 566,447
Commercial - Real Estate	7,758,574	7,758,574	667,988	3,907,839	394,275
Consumer - Non Real Estate	150,102	150,102	81,440	169,818	12,781
Residential - Real Estate	1,598,699	1,598,699	409,967	1,900,573	83,853
	$ 17,137,545	$ 17,137,545	$ 2,876,471	$ 15,217,307	$ 1,057,356

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2013					
With no related allowance:					
Commercial - Non Real Estate					
Secured	$ 2,167,535	$ 2,167,535	$ —	$ 2,189,327	$ 153,642
Unsecured	49,430	49,430	—	143,145	4,273
Commercial - Real Estate					
Acquisition and development	432,738	432,738	—	1,136,140	21,033
Non-owner occupied	7,057,383	7,057,383	—	5,520,903	434,150
Owner occupied	1,709,878	1,709,878	—	1,810,493	50,759
Multifamily	—	—	—	—	—
Consumer - Non Real Estate					
Installment	50,754	50,754	—	40,957	967
Revolving	97,953	97,953	—	64,520	3,972
Other	—	—	—	—	—
Residential - Real Estate					
First Lien 1-4 Family	731,396	731,396	—	1,124,603	36,080
Junior Lien 1-4 Family	—	—	—	2,613	—
Construction	—	—	—	147,333	—
Land	189,909	189,909	—	233,859	8,941
Revolving	686,205	686,205	—	804,370	50,741
With an allowance recorded:					
Commercial - Non Real Estate					
Secured	$ 10,372,318	$ 10,372,318	$ 1,289,450	$ 4,411,905	$ 157,386
Unsecured	250,000	250,000	36,595	180,998	15,842
Commercial - Real Estate					
Acquisition and development	—	—	—	—	—
Non-owner occupied	201,941	201,941	96,094	1,045,697	4,515
Owner occupied	1,690,583	1,690,583	212,220	1,230,248	96,517
Multifamily	—	—	—	—	—
Consumer - Non Real Estate					
Installment	141,159	141,159	126,613	130,341	4,975
Revolving	2,337	2,337	2,334	26,665	346
Other	—	—	—	—	—
Residential - Real Estate					
First Lien 1-4 Family	782,232	782,232	92,167	334,838	30,081
Junior Lien 1-4 Family	122,614	122,614	122,614	42,408	10,882
Construction	227,589	227,589	44,256	227,662	17,640
Land	—	—	—	285,028	—
Revolving	728,835	728,835	352,489	643,286	15,720
Total:					
Commercial - Non Real Estate	$ 12,839,283	$ 12,839,283	$ 1,326,045	$ 6,925,375	$ 331,143
Commercial - Real Estate	11,092,523	11,092,523	308,314	10,743,481	606,974
Consumer - Non Real Estate	292,203	292,203	128,947	262,483	10,260
Residential - Real Estate	3,468,780	3,468,780	611,526	3,846,000	170,085
	$ 27,692,789	$ 27,692,789	$ 2,374,832	$ 21,777,339	$ 1,118,462

Included in impaired loans are troubled debt restructurings. At December 31, 2014 and 2013, $12,222,948 and $17,709,929 in loans were modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the loan's interest rate, payment extensions, or other actions intended to maximize collection.

There were no loans modified in a troubled debt restructuring during 2014.

There were no loans that subsequently defaulted (more than 90 days past due or charge-off) within the first year of modification during 2014.

At December 31, 2014, no additional funds were committed to be advanced in connection with impaired loans.

Information regarding activity in troubled debt restructurings by class during 2013 follows:

2013	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial - Non Real Estate			
Secured	4	$ 9,121,556	$ 9,121,556
Commercial - Real Estate			
Owner occupied	2	743,928	743,928
Residential - Real Estate			
First Lien 1-4 Family	2	539,032	539,032
Consumer	1	27,182	27,182
	9	$ 10,431,698	$ 10,431,698

One consumer loan of $27,182 subsequently defaulted (more than 90 days past due or charge-off) within the first year of modification during 2013.

At December 31, 2013, $715,445 was committed to be advanced in connection with impaired loans.

The Bank's credit quality information, which is based on internal risk grades, follows:

	Pass	Watch	Special Mention	Substandard	Doubtful	Loss	Total
December 31, 2014							
Commercial - Non Real Estate							
Secured	$ 99,953,733	$ 342,124	$ 5,169,026	$ 7,270,921	$ —	$ —	$ 112,735,804
Unsecured	7,793,281	—	102,651	263,694	23,315	—	8,182,941
Commercial - Real Estate							
Acquisition and development	23,608,273	—	—	453,726	—	—	24,061,999
Non-owner occupied	61,372,917	2,666,253	—	187,878	—	—	64,227,048
Owner occupied	69,773,329	1,104,097	6,163,540	1,640,533	—	—	78,681,499
Multifamily	7,797,263	—	—	—	—	—	7,797,263
Consumer - Non Real Estate							
Installment	8,717,779	—	330,641	135,020	10,888	—	9,194,328
Revolving	1,747,490	—	—	4,194	—	—	1,751,684
Other	180,904	—	—	—	—	—	180,904
Residential - Real Estate							
First Lien 1-4 Family	33,871,483	897,661	454,516	624,263	—	—	35,847,923
Junior Lien 1-4 Family	4,765,446	16,769	12,403	—	15,181	—	4,809,799
Construction	4,137,081	—	—		—	—	4,137,081
Land	7,008,486	61,584	267,271	57,369	—	—	7,394,710
Revolving	30,736,123	302,826	856,037	366,908	405,325	—	32,667,219
Total	$ 361,463,588	$ 5,391,314	$ 13,356,085	$ 11,004,506	$ 454,709	$ —	$ 391,670,202
December 31, 2013							
Commercial - Non Real Estate							
Secured	$ 94,932,946	$ 5,718,861	$ 3,411,377	$ 11,661,774	$ 95,230	$ —	$ 115,820,188
Unsecured	8,225,668	18,078	22,660	299,430	—	—	8,565,836
Commercial - Real Estate							
Acquisition and development	24,038,802	—	—	432,738	—	—	24,471,540
Non-owner occupied	45,388,978	197,529	—	7,259,323	—	—	52,845,830
Owner occupied	63,973,329	11,882,686	238,233	2,658,291	—	—	78,752,539
Multifamily	7,772,554	—	—	—	—	—	7,772,554
Consumer - Non Real Estate							
Installment	8,181,973	28,499	14,430	175,613	16,300	—	8,416,815
Revolving	1,691,979	3,047	—	99,911	379	—	1,795,316
Other	—	—	—	—	—	—	—
Residential - Real Estate							
First Lien 1-4 Family	27,495,896	1,219,397	671,841	1,122,913	—	—	30,510,047
Junior Lien 1-4 Family	3,975,957	1,179	15,415	122,614	—	—	4,115,165
Construction	4,596,444	—	—	227,589	—	—	4,824,033
Land	7,917,955	68,288	441,854	189,909	—	—	8,618,006
Revolving	31,114,384	783,178	778,225	1,073,770	341,270	—	34,090,827
Total	$ 329,306,865	$ 19,920,742	$ 5,594,035	$ 25,323,875	$ 453,179	$ —	$ 380,598,696

The following is a summary of information pertaining to nonaccrual and past due loans by class:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Nonaccruals	Current	Total Loans
December 31, 2014							
Commercial - Non Real Estate							
Secured	$ 180,252	$ 20,712	$ —	$ 200,964	$ 6,063,260	$ 106,471,580	$ 112,735,804
Unsecured	5,500	—	—	5,500	74,619	8,102,822	8,182,941
Commercial - Real Estate							
Acquisition and development	—	—	—	—	453,726	23,608,273	24,061,999
Non-owner occupied	—	—	—	—	187,878	64,039,170	64,227,048
Owner occupied	976,156	—	—	976,156	307,120	77,398,223	78,681,499
Multifamily	—	—	—	—	—	7,797,263	7,797,263
Consumer - Non Real Estate							
Installment	4,862	—	—	4,862	51,131	9,138,335	9,194,328
Revolving	—	—	—	—	—	1,751,684	1,751,684
Other	16,424	—	—	16,424	—	164,480	180,904
Residential - Real Estate							
First Lien 1-4 Family	357,322	442,817	—	800,139	552,062	34,495,722	35,847,923
Junior Lien 1-4 Family	29,172	—	—	29,172	—	4,780,627	4,809,799
Construction	—	—	—	—	—	4,137,081	4,137,081
Land	196,652	—	—	196,652	53,876	7,144,182	7,394,710
Revolving	495,894	71,085	—	566,979	680,452	31,419,788	32,667,219
Total	$ 2,262,234	$ 534,614	$ —	$ 2,796,848	$ 8,424,124	$ 380,449,230	$ 391,670,202
December 31, 2013							
Commercial - Non Real Estate							
Secured	$ 1,158,656	$ —	$ —	$ 1,158,656	$ 8,807,108	$ 105,854,424	$ 115,820,188
Unsecured	—	—	—	—	22,828	8,543,008	8,565,836
Commercial - Real Estate							
Acquisition and development	—	—	—	—	432,738	24,038,802	24,471,540
Non-owner occupied	—	—	—	—	2,764,575	50,081,255	52,845,830
Owner occupied	629,983	—	—	629,983	304,846	77,817,710	78,752,539
Multifamily	—	—	—	—	—	7,772,554	7,772,554
Consumer - Non Real Estate							
Installment	13,527	3,262	—	16,789	124,191	8,275,835	8,416,815
Revolving	—	—	3,071	3,071	—	1,792,245	1,795,316
Other	—	—	—	—	—	—	—
Residential - Real Estate							
First Lien 1-4 Family	415,156	306,927	—	722,083	1,459,699	28,328,265	30,510,047
Junior Lien 1-4 Family	17,019	—	—	17,019	122,614	3,975,532	4,115,165
Construction	—	—	—	—	—	4,824,033	4,824,033
Land	185,685	—	—	185,685	189,909	8,242,412	8,618,006
Revolving	848,051	76,143	—	924,194	902,071	32,264,562	34,090,827
Total	$ 3,268,077	$ 386,332	$ 3,071	$ 3,657,480	$ 15,130,579	$ 361,810,637	$ 380,598,696

Internal risk rating definitions are:

Pass/Watch: These include satisfactory loans which may have elements of risk that the Bank has chosen to monitor formally. The objective of monitoring is to assure that no weaknesses develop in these loans.

Special Mention: These loans have a potential weakness that requires management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. These credits do not expose the Bank to sufficient risk to warrant further adverse classification.

Substandard: A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as such must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified doubtful have all the weaknesses inherent in a substandard asset with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss: Loans classified loss are considered uncollectible and of such little value that their continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be received in the future.

Note 4. Premises and Equipment

A summary of the cost and accumulated depreciation of premises and equipment follows:

	December 31,	
	2014	2013
Land	$ 4,790,653	$ 3,790,653
Buildings	15,846,591	14,809,925
Furniture, fixtures and improvements	2,240,749	2,164,458
Mechanical equipment	7,372,569	6,548,515
Leasehold improvements	4,081,534	4,081,534
	$ 34,332,096	$ 31,395,085
Less accumulated depreciation	17,076,057	15,698,386
	$ 17,256,039	$ 15,696,699

For the years ended December 31, 2014 and 2013, depreciation expense was $1,442,057 and $1,490,736, respectively.

Note 5. Borrowings

CFS's fixed-rate long-term debt of $10,390,339 at December 31, 2014 matures through 2018. $210,253 of the long-term debt is secured by a deed of trust on property located in Lancaster County, Virginia with a carrying value of approximately $675,000. $10,000,000 of the long-term debt consists of fixed-rate credits from the Federal Home Loan Bank (FHLB). These credits have rates ranging from 3.21% to 3.44% and mature through 2018. The remainder of the long-term debt is an advance from the FHLB's EDGE Project. CFS borrowed $1,000,000 at 1.00% to fund a local non-profit project. The remaining balance at December 31, 2014 for this borrowing was $180,086. Aggregate maturities are: 2015, $142,875; 2016, $148,893; 2017, $92,411; 2018, $10,006,160.

CFS has unsecured lines of credit with correspondent banks totaling $54,000,000 available for overnight borrowing. No balances were outstanding on these lines at December 31, 2014.

Note 6. Income Taxes

The components of the net deferred tax asset, included in other assets, are as follows:

	December 31, 2014	December 31, 2013
Deferred tax assets:		
Allowance for loan and cash management account losses	$ 2,622,675	$ 2,383,074
Other real estate	279,694	283,214
Deferred compensation	39,440	48,202
Premises and equipment	198,646	79,720
Restricted stock	45,859	—
AMT tax credit carryforward	252,491	—
Other	88,767	80,220
	$ 3,527,572	$ 2,874,430
Deferred tax liabilities:		
Securities available for sale	$ 3,197,756	$ 1,270,427
Net deferred tax assets	$ 329,816	$ 1,604,003

The provision for income taxes charged to operations for the years ended December 31, 2014 and 2013, consists of the following:

	2014	2013
Current tax expense	$ 1,807,727	$ 845,016
Deferred tax	(653,142)	951,140
	$ 1,154,585	$ 1,796,156

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate to pretax income for the years ended December 31, 2014 and 2013, due to the following:

	2014	2013
Computed "expected" tax expense	$ 2,614,074	$ 3,110,731
(Decrease) increase in income taxes resulting from:		
Tax exempt income	(1,578,148)	(1,456,701)
Other	118,659	142,126
	$ 1,154,585	$ 1,796,156

CFS, on a consolidated basis, files income tax returns in the U.S. federal jurisdiction and the Commonwealth of Virginia. With few exceptions, CFS is no longer subject to U.S. federal or state income tax examinations by tax authorities for years before 2011.

Note 7. Employee Benefit Plans

Deferred Compensation Agreements

CFS has a deferred compensation agreement providing for monthly payments to an officer commencing at retirement. The liability under this agreement was accrued over the officer's period of employment such that the present value of the monthly payments was accrued by retirement date. CFS funded the deferred compensation commitment through life insurance policies on the officer. The officer is currently receiving benefits under this plan.

Employee Stock Ownership Plan

CFS sponsors a leveraged employee stock ownership plan (ESOP) that generally covers full-time employees who have completed one calendar year of service. CFS makes annual contributions to the ESOP equal to the ESOP's debt service and certain additional contributions at the discretion of the board of directors. The ESOP is internally leveraged through a loan from the Bank to the ESOP. Certain ESOP shares are pledged as collateral for its debt. As the debt is repaid, shares are released from collateral and allocated to active employees, based on the proportion of debt service paid in the year. Shares pledged as collateral are deducted from shareholders' equity as unearned ESOP shares in the accompanying consolidated balance sheets. At December 31, 2014, 12,000 shares remained as collateral securing the note payable.

The note payable referred to in the preceding paragraph requires annual principal payments plus interest at the prime interest rate adjusted annually with a floor of 5.50%. Future principal payments of $138,400 are due annually through 2015.

As shares are released from collateral, CFS reports compensation expense equal to the current market price of the shares and the shares become outstanding. Dividends on allocated ESOP shares are recorded as a reduction of retained earnings. Dividends on unallocated ESOP shares are recorded as a reduction of debt and accrued interest. ESOP compensation expense was $553,066 and $542,023 for the years ended December 31, 2014 and 2013, respectively (including $218,419 and $216,788 for the years ended December 31, 2014 and 2013 related to the release of ESOP shares).

401(k) Plan

CFS has adopted a contributory 401(k) plan that covers substantially all employees. Under the plan, employees may elect to defer up to 100% of their salary, subject to Internal Revenue Service limits. CFS will make a matching contribution of 100% of the first 3% and 50% of the second 3% of the employee's salary deferred. CFS may also make a discretionary contribution to the plan. Total expense related to the plan was $414,516 and $416,937 for 2014 and 2013, respectively.

Note 8. Stock Option Plans

In 1996, CFS adopted an incentive stock option plan that reserved for issuance 362,880 shares of CFS's voting common stock. The plan's expiration date was March 31, 2006. On April 1, 2005, CFS's shareholders approved an incentive stock option plan under which options or restricted stock may be granted to certain key employees. The plan reserves 224,600 shares of voting common stock for issuance and expires on January 21, 2015. The compensation cost that has been charged against income for those plans related to stock options was $37,096 and $66,004 for the years ended December 31, 2014 and 2013, respectively. No income tax benefit was recognized in the income statement for stock-based compensation arrangements for the years ended December 31, 2014 and 2013.

On April 4, 2014, CFS's shareholders approved a stock incentive plan under which options or restricted stock may be granted to certain key employees. The plan reserves 420,000 shares of voting common stock for issuance and expires on January 16, 2024. There was no compensation cost charged to income for those plans related to stock options for 2014.

The stock option plans require that options be granted at an exercise price equal to at least 100% of the fair market value of the common stock on the date of the grant; however, for those individuals who own more than 10% of the stock of CFS, the option price must be at least 110% of the fair market value on the date of grant. Such options are generally not exercisable until three years from the date of issuance and require continuous employment during the period prior to exercise. The options will expire in no more than ten years after the date of grant.

All restricted stock and stock option information has been retroactively restated to give effect to the stock split described in Note 9.

A summary of the option activity under the plans at December 31, 2014 and changes during the year then ended are as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	338,962	$ 10.74		
Granted	—			
Exercised	(36,316)	9.20		
Expired and Forfeited	(26,949)	10.55		
Outstanding at end of year	275,697	10.97	4.1	$ 1,239,296
Options exercisable, end of year	226,497	10.86	3.4	$ 1,042,412

Aggregate intrinsic value of stock options represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all the option holders exercised their options on December 31, 2014. This amount changes based on changes in the market value of CFS's stock.

There were no stock options granted during the year ended December 31, 2014. The total intrinsic value of options exercised during the year ended December 31, 2014 and 2013, was $197,748 and $599,013, respectively.

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the assumptions noted in the following table. Expected volatility is based on the historic volatility of CFS's stock price over the expected life of the options. The expected term is estimated as the average of the contractual life and vesting schedule for the respective options. The risk-free interest rate is the U.S. Treasury zero-coupon issue with a remaining term equal to the expected term of the options granted. The dividend yield is estimated as the ratio of CFS's historical dividends paid per share of common stock to the stock price on the date of grant.

	2013
Dividend yield	2.38%
Expected term	6 years
Expected volatility	17.52%
Risk-free interest rate	2.72%

As of December 31, 2014 and 2013, there was $39,930 and $68,732 of total unrecognized compensation cost related to nonvested stock-based compensation arrangements granted under the plans. That cost is expected to be recognized over a weighted average period of .30 years.

Restricted Stock

The Company grants shares of restricted stock to key employees. These awards help align the interests of these employees with the interests of the shareholders of the Company by providing economic value directly related to increases in the value of the Company's common stock. The value of the stock awarded is established as the fair market value of the stock at the time of grant. The Company recognizes expense, equal to the total value of such awards, ratably over the vesting period of the stock grants. Restricted stock vests over 36 months based on the term of the award.

Nonvested restricted stock activity for the year ended December 31, 2014 is summarized in the following table:

	Shares	Weighted Average Grant Date Value
Nonvested at January 1, 2014	31,740	$ 15.60
Granted	31,260	15.21
Vested	(10,175)	15.60
Expired and Forfeited	(3,445)	15.44
Nonvested at December 31, 2014	49,380	15.36

At December 31, 2014, there was $260,673 in unrecognized compensation cost related to nonvested restricted stock granted under the 2005 Plan. This cost is expected to be recognized over the next 18 months. At December 31, 2014, there was $402,972 in unrecognized compensation cost related to nonvested restricted stock granted under the 2014 Plan. This cost is expected to be recognized over the next 30 months. Share based compensation expense for nonvested restricted stock totaled $222,278 and $68,770 during 2014 and 2013, respectively.

Note 9. Shareholders' Equity

During 2014 and 2013, CFS issued 6,262 shares and 5,826 shares, respectively, of common stock to its directors for partial compensation.

On July 18, 2014, the Board of Directors approved a 6-for-5 stock split of CFS's common stock payable on or before October 15, 2014. All per share information for all periods presented has been retroactively restated to reflect the stock split.

Note 10. Commitments and Contingencies

CFS leases certain facilities and equipment under operating leases which expire at various dates through 2019. These leases generally contain renewal options and require CFS to pay taxes, insurance, maintenance and other expenses in addition to the minimum normal rentals.

Minimum rental payments under these operating lease agreements as of December 31, 2014 are as follows:

Year Ending December 31,	
2015	$ 123,081
2016	18,030
2017	18,481
2018	18,943
2019	19,416

Rent expense under operating leases aggregated $369,394 and $367,786 for the years ended December 31, 2014 and 2013, respectively.

As a member of the Federal Reserve System, the Bank is required to maintain certain average reserve balances. For the final weekly reporting period in the years ended December 31, 2014 and 2013, the aggregate amounts of daily average required balances were approximately $1,438,000 and $1,295,000, respectively.

Note 11. Related Party Transactions

Officers, directors and their affiliates had borrowings of $9,015,105 and $9,088,803 at December 31, 2014 and 2013, respectively, with the Bank.

Changes in borrowings during 2014 were as follows:

Balance, December 31, 2013	$ 9,088,803
Additions	6,548,499
Payments	(6,622,197)
Balance, December 31, 2014	$ 9,015,105

These transactions occurred in the ordinary course of business on substantially the same terms as those prevailing at the time for comparable transactions with unrelated persons.

Related parties had deposits of $1,410,832 and $999,897 as of December 31, 2014 and 2013, respectively.

Note 12. Other Income and Expenses

The principal components of "Other Income" in the consolidated statements of income are:

	2014	2013
Cash management fees and discount	$ 2,953,032	$ 3,589,674
Merchant discount	4,743,700	5,285,306
ATM fee income	1,148,725	1,129,865
Asset management fees	854,645	880,322
Gain on redemption of trust preferred capital notes	1,100,000	—
Other (includes no items in excess of 1% of total revenue)	2,183,332	2,640,481
	$ 12,983,434	$ 13,525,648

The principal components of "Other Expenses" in the consolidated statements of income are:

	2014	2013
Advertising	$ 809,853	$ 917,826
Merchant card	2,645,388	3,027,949
Software	942,508	969,296
Provision for cash management account losses	550,000	742,666
Legal fees	1,088,535	725,267
FDIC assessments	846,070	572,045
Delivery and transportation	233,442	220,647
Stationery and supplies	370,074	390,504
Other (includes no items in excess of 1% of total revenue)	5,079,564	4,696,417
	$ 12,565,434	$ 12,262,617

Note 13. Earnings Per Common Share

The following data shows the amounts used in computing earnings per common share and the effect on the weighted average number of shares of dilutive potential common stock. The potential common stock did not have an impact on net income. All shares have been retroactively restated to give effect to the stock split described in Note 9.

	2014	2013
Weighted average number of common shares, basic	3,950,444	3,878,165
Effect of dilutive stock options	80,586	112,866
Weighted average number of common shares and dilutive potential common stock used in diluted EPS	4,031,030	3,991,031

There were no antidilutive options for the years ended December 31, 2014 and 2013.

Note 14. Time Deposits

Remaining maturities on certificates of deposit are as follows:

2015	$ 104,044,459
2016	27,397,155
2017	9,490,790
2018	8,987,740
2019	5,448,156
Thereafter	33,328,000
	$ 188,696,300

The Bank obtains certain deposits through the efforts of third-party brokers. At December 31, 2014 and 2013, brokered deposits totaled $39,942,000 and $41,587,000, respectively, and were included in certificates of deposit on the consolidated balance sheets.

Note 15. Financial Instruments With Off-Balance-Sheet Risk

The Bank is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financial needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

At December 31, 2014 and 2013, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount	
	2014	2013
	(in thousands)	
Commitments to grant loans	$ 5,154	$ 11,747
Unfunded commitments under lines of credit	108,961	105,517
Commercial and standby letters of credit	2,492	2,135

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments, if deemed necessary.

CFS maintains its cash accounts in several correspondent banks. The total amount by which cash on deposit in those banks exceeds the federally insured limits is approximately $1,623,794 at December 31, 2014.

Note 16. Fair Value of Assets and Liabilities

Determination of Fair Value

CFS uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are not quoted market prices for CFS's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

Fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with this guidance, CFS groups its financial assets and financial liabilities generally measured at fair value in 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 - Valuation is based on quoted prices in active markets for identical assets and liabilities and generally includes debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 - Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following methods and assumptions were used by CFS in estimating fair value disclosures for financial instruments:

Cash and Cash Equivalents and Interest-Bearing Deposits in Banks

The carrying amounts of cash and short-term instruments approximate fair values based on the short-term nature of the assets.

Securities

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data (Level 2). If the inputs used to provide the evaluation for certain securities are unobservable and/or there is little, if any, market activity then the security would fall to the lowest level of the hierarchy (Level 3).

The Company's investment portfolio is primarily valued using fair value measurements that are considered to be Level 2. The Company has contracted with a third party portfolio accounting service vendor for valuation of its securities portfolio. The vendor's primary source for security valuation is Interactive Data Corporation ("IDC"), which evaluates securities based on market data. IDC utilizes evaluated pricing models that vary by asset class and include available trade, bid, and other market information. Generally, the methodology includes broker quotes, proprietary modes, vast descriptive terms and conditions databases, as well as extensive quality control programs.

The vendor utilizes proprietary valuation matrices for valuing all municipal securities. The initial curves for determining the price, movement, and yield relationships within the municipal matrices are derived from industry benchmark curves or sourced from a municipal trading desk. The securities are further broken down according to issuer, credit support, state of issuance and rating to incorporate additional spreads to the industry benchmark curves.

The Company uses Bloomberg Valuation Service, an independent information souce that draws on quantitative models and market data contributed from over 4,000 market participants, to validate third party valuations. Any material differences between valuation sources are researched by further analyzing the various inputs that are utilized by each pricing source.

Loans Receivable

Fair values for loans are estimated using discounted cash flow analyses, using market interest rates for comparable loans. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Cash Management Accounts

The carrying value of cash management accounts approximates their fair value. The future cash flows from these accounts are short-term in nature (less than 90 days) and the rate of return approximates current market rates.

Bank-Owned Life Insurance

The carrying value of bank-owned life insurance is based on cash surrender value and approximates fair value.

Deposit Liabilities

The fair values disclosed for demand deposits (for example, interest and noninterest checking, savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit, if any, approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates on comparable instruments to a schedule of aggregated expected monthly maturities on time deposits.

Short-Term Borrowings

The carrying amounts of federal funds purchased and other short-term borrowings maturing within ninety days approximate their fair values. Fair values of other short-term borrowings are estimated using discounted cash flow analyses based on current market rates and similar types of borrowing arrangements.

Long-Term Borrowings

Current market rates for debt with similar terms and remaining maturities are used to estimate fair value of existing debt. Fair value of long-term debt is based on quoted market prices or dealer quotes for the identical liability when traded as an asset in an active market. If a quoted market price is not available, an expected present value technique is used to estimate fair value.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Off-Balance-Sheet Credit-Related Instruments

Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing.

Assets Measured at Fair Value on a Recurring Basis

The following table presents the balances of financial assets measured at fair value on a recurring basis as of December 31, 2014 and 2013:

		Fair Value Measurements at December 31, 2014 Using		
Description	**Carrying Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
		(in thousands)		
Assets:				
Securities of state and political subdivisions	$ 122,533	$ —	$ 122,533	$ —
Mortgage-backed securities	67,767	—	59,910	7,857

		Fair Value Measurements at December 31, 2013 Using		
Description	**Carrying Value**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
		(in thousands)		
Assets:				
Securities of state and political subdivisions	$ 106,620	$ —	$ 106,620	$ —
Mortgage-backed securities	57,821	—	50,267	7,554

The following tables present the changes in Level 3 assets that are measured at fair value on a recurring basis for the year ended December 31, 2014 and 2013:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)					
		Total Realized/Unrealized Gains (Losses) Included in				
	Balance as of January 1, 2014	Net Income	Other Comprehensive Income	Purchases, Sales, Issuances, and Settlements, Net	Transfers in and/or Out of Level 3	Balance as of December 31, 2014
			(in thousands)			
Mortgage-backed securities	$ 7,554	$ (369)	$ (66)	$ —	$ (738)	$ 7,857

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)					
		Total Realized/Unrealized Gains (Losses) Included in				
	Balance as of January 1, 2013	Net Income	Other Comprehensive Income	Purchases, Sales, Issuances, and Settlements, Net	Transfers in and/or Out of Level 3	Balance as of December 31, 2013
			(in thousands)			
Mortgage-backed securities	$ 26,146	$ (838)	$ 1,882	$ (4,441)	$ (15,195)	$ 7,554

Assets Measured at Fair Value on a Nonrecurring Basis

Under certain circumstances, CFS makes adjustments to fair value for the Company's assets and liabilities although they are not measured at fair value on an ongoing basis. The following table presents assets carried on the consolidated balance sheet by caption and by level in the fair value hierarchy at December 31, 2014 and 2013, for which a nonrecurring change in fair value has been recorded:

	Fair Value Measurements at December 31, 2014 Using (in thousands)		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ —	$ —	$ 11,295
Other real estate owned	—	—	2,701

	Fair Value Measurements at December 31, 2013 Using (in thousands)		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans	$ —	$ —	$ 12,145
Other real estate owned	—	—	4,015

Fair Value Measurements at December 31, 2014

	Fair Value	Valuation Techniques	Unobservable Inputs	Weighted Average
Assets				
Commercial - Non Real Estate	$ 5,440	Market comparables	Discount applied to market comparables [1]	24.0%
Commercial - Real Estate	5,675	Market comparables	Discount applied to market comparables [1]	10.5%
Residential - Real Estate	153	Market comparables	Discount applied to market comparables [1]	72.8%
Consumer - Non Real Estate	27	Market comparables	Discount applied to market comparables [1]	74.8%
Total Impaired Loans	$ 11,295			
Other Real Estate Owned	$ 2,701	Market comparables	Discount applied to market comparables [1]	19.5%
Total	$ 13,996			

[1] A discount percentage is applied based on age of independent appraisals, selling costs, current market conditions, and experience within the local market.

Fair Value Measurements at December 31, 2013

	Fair Value	Valuation Techniques	Unobservable Inputs	Weighted Average
Assets				
Commercial - Non Real Estate	$ 9,296	Market comparables	Discount applied to market comparables [1]	12.5%
Commercial - Real Estate	1,584	Market comparables	Discount applied to market comparables [1]	16.3%
Residential - Real Estate	1,250	Market comparables	Discount applied to market comparables [1]	32.9%
Consumer - Non Real Estate	15	Market comparables	Discount applied to market comparables [1]	89.9%
Total Impaired Loans	$ 12,145			
Other Real Estate Owned	$ 4,015	Market comparables	Discount applied to market comparables [1]	17.2%
Total	$ 16,160			

[1] A discount percentage is applied based on age of independent appraisals, selling costs, current market conditions, and experience within the local market.

Impaired Loans

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreements will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the Company's collateral is real estate. The value of real estate is determined utilizing an income or market valuation approach based on an appraisal, of one year or less, conducted by an independent, licensed appraiser using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the property is more than one year old and not solely based on observable market comparables, or management determines the fair value of the collateral is further impaired below the appraised value, then a Level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal, of one year or less, if deemed significant, or the net book value on the applicable business' financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Foreclosed Assets

Fair values of other real estate owned ("OREO") are carried at the lower of carrying value or fair value less selling costs. Fair value is based upon independent market prices, appraised values of the collateral, or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the foreclosed asset as Level 2 valuation. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the foreclosed asset as Level 3 valuation. Any fair value adjustments are recorded in the period incurred and expensed against current earnings.

The estimated fair values, and related carrying or notional amounts, of CFS's financial instruments are as follows (dollars in thousands):

		Fair Value Measurements at December 31, 2014			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total Fair Value
Financial assets:					
Cash and short-term investments	$ 26,665	$ 26,665	$ —	$ —	$ 26,665
Securities available for sale	190,299	—	182,442	7,857	190,299
Restricted stock	2,287	—	—	2,287	2,287
Loans, net	385,304	—	391,555	11,295	402,850
Cash management accounts, net	17,186	—	19,268	—	19,268
Accrued interest receivable	2,922	—	2,922	—	2,922
Bank-owned life insurance	10,765	—	10,765	—	10,765
Financial liabilities:					
Deposits	$ 562,721	$ —	$ 566,400	$ —	$ 566,400
Long-term debt	20,700	—	21,100	—	21,100
Accrued interest payable	148	—	148	—	148

		Fair Value Measurements at December 31, 2013			
	Carrying Value	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total Fair Value
Financial assets:					
Cash and short-term investments	$ 59,885	$ 59,885	$ —	$ —	$ 59,885
Securities available for sale	164,441	—	156,887	7,554	164,441
Restricted stock	1,873	—	—	1,873	1,873
Loans, net	374,275	—	386,349	12,145	398,494
Cash management accounts, net	19,721	—	19,721	—	19,721
Accrued interest receivable	2,738	—	2,738	—	2,738
Bank-owned life insurance	10,457	—	13,357	—	13,357
Financial liabilities:					
Deposits	$ 572,405	$ —	$ 553,394	$ —	$ 553,394
Long-term debt	25,992	—	26,753	—	26,753
Accrued interest payable	184	—	184	—	184

CFS assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair values of CFS's financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable to CFS. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to prepay in a rising rate environment and more likely to prepay in a falling rate environment. Conversely, depositors who are receiving fixed rates are more likely to withdraw funds before maturity in a rising rate environment and less likely to do so in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate CFS's overall interest rate risk.

Note 17. Minimum Regulatory Capital Requirements

CFS and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on CFS's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, financial institutions must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. A financial institution's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require financial institutions to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2014 and 2013, that CFS meets all capital adequacy requirements to which it is subject.

As of December 31, 2014, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

CFS's and Chesapeake Bank's actual capital amounts and ratios are also presented in the table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2014:						
Total Capital (to Risk Weighted Assets):						
Consolidated	$ 80,750	16.0%	$ 40,520	8.0%	N/A	
Chesapeake Bank	$ 75,076	15.0%	$ 40,154	8.0%	$ 50,193	10.0%
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	$ 74,402	14.7%	$ 20,260	4.0%	N/A	
Chesapeake Bank	$ 68,784	13.7%	$ 20,077	4.0%	$ 30,116	6.0%
Tier 1 Capital (to Average Assets):						
Consolidated	$ 74,402	11.2%	$ 26,520	4.0%	N/A	
Chesapeake Bank	$ 68,784	10.5%	$ 26,220	4.0%	$ 32,775	5.0%
As of December 31, 2013:						
Total Capital (to Risk Weighted Assets):						
Consolidated	$ 80,895	15.5%	$ 41,797	8.0%	N/A	
Chesapeake Bank	$ 76,156	14.7%	$ 41,434	8.0%	$ 51,792	10.0%
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	$ 74,358	14.3%	$ 20,898	4.0%	N/A	
Chesapeake Bank	$ 69,675	13.5%	$ 20,717	4.0%	$ 31,075	6.0%
Tier 1 Capital (to Average Assets):						
Consolidated	$ 74,358	11.2%	$ 26,592	4.0%	N/A	
Chesapeake Bank	$ 69,675	10.7%	$ 26,017	4.0%	$ 32,521	5.0%

Note 18. Trust Preferred Capital Notes

On July 2, 2007, CFS Capital Trust II, a wholly-owned subsidiary of CFS, was formed for the purpose of issuing redeemable capital securities. On July 5, 2007, $15.465 million of trust preferred securities were issued through a pooled underwriting totaling approximately $611 million. The securities have a LIBOR-indexed floating rate of interest. The weighted-average interest rate for the year ended December 31, 2014 was 1.62%. The interest rate as of December 31, 2014 was 1.62 %. The securities have a mandatory redemption date of October 1, 2037, and are subject to varying call provisions beginning September 6, 2012.

In August 2014, CFS was notified that $5.0 million of the $15.0 million in trust preferred securities of CFS Capital Trust II ("Trust II") would be auctioned off as part of a larger pooled collateralized debt obligation liquidation. CFS placed a bid of $3.9 million for the securities which was accepted by the trustee and the transaction closed on September 5, 2014. Because the accepted bid of $3.9 million was less than the $5.0 million carrying value, CFS recognized a gain of $1.1 million related to this transaction, when these securities were redeemed. As of December 31, 2014, $10.0 million in common stock of Trust II was still outstanding.

The Trust Preferred Securities may be included in Tier 1 capital for regulatory capital adequacy determination purposes up to 25% of Tier 1 capital after its inclusion. The portion of the Trust Preferred not considered as Tier 1 capital may be included in Tier 2 capital.

The obligations of CFS with respect to the issuance of the capital securities constitute a full and unconditional guarantee by CFS of the Trust's obligations with respect to the capital securities.

Subject to certain exceptions and limitations, CFS may elect from time to time to defer interest payments on the junior subordinated debt securities, which would result in a deferral of distribution payments on the related capital securities.

Note 19. Accumulated Other Comprehensive Income

Changes in each component of accumulated other comprehensive income for the years ended December 31, 2014 and 2013 were as follows:

	Net Unrealized Gains (Losses) on Securities, Net
Balance at December 31, 2013	$ 2,466,124
Unrealized gains on securities available for sale, net of tax of $1,861,870	3,614,218
Reclassification adjustment, net of tax of ($65,459)	127,068
Balance at December 31, 2014	$ 6,207,410
Balance at December 31, 2012	$ 7,527,192
Unrealized (losses) on securities available for sale, net of tax of $(2,479,095)	(4,812,361)
Reclassification adjustment, net of tax of $128,122	(248,707)
Balance at December 31, 2013	$ 2,466,124

Details regarding reclassifications out of accumulated other comprehensive income for the years ended December 31, 2014 and 2013 were as follows:

Reclassifications Out of Accumulated Other Comprehensive Income for the Year Ended December 31, 2014:

Details about AOCI Components	Amount Reclassified from AOCI	Affected Line Item in the Consolidated Income Statement
Realized gain on sale of securities	$ 176,673	Net gain on sales of securities available for sale
Other-than-temporary impairment on securities	(369,200)	Net other-than-temporary impairment losses on investments recognized in earnings
Income tax expense	65,459	Income tax benefit
Total reclassifications	$ (127,068)	Net of tax

Reclassifications Out of Accumulated Other Comprehensive Income for the Year Ended December 31, 2013:

Details about AOCI Components	Amount Reclassified from AOCI	Affected Line Item in the Consolidated Income Statement
Realized gain on sale of securities	$ 952,682	Net gain on sales of securities available for sale
Other-than-temporary impairment on securities	(575,853)	Net other-than-temporary impairment losses on investments recognized in earnings
Income tax expense	(128,122)	Income tax expense
Total reclassifications	$ 248,707	Net of tax

Note 20. Condensed Parent Company Financial Statements

The following parent company accounting policies should be read in conjunction with the related condensed balance sheets, statements of income, and statements of cash flows.

Investments in subsidiaries are accounted for using the equity method of accounting. The parent company and its subsidiaries file a consolidated federal income tax return. The subsidiaries' individual tax provisions and liabilities are stated as if they filed separate returns and any benefits or detriments of filing the consolidated tax return are absorbed by the parent company.

The parent company's principal assets are its investments in its wholly-owned subsidiaries. Dividends from the Bank are the primary source of funds for the parent company. The payment of dividends by the Bank is restricted by various statutory limitations. Banking regulations also prohibit extensions of credit by the Bank to the parent company unless appropriately secured by assets. As of December 31, 2014, the amount available for payment of additional dividends without prior regulatory approval from the Bank to the parent company is $8,611,688 or 12.23% of consolidated net assets.

Balance Sheets (Condensed)

	December 31, 2014	December 31, 2013
Assets		
Cash	$ 1,145,321	$ 990,990
Investment in subsidiaries	77,169,964	74,013,759
Premises and equipment, net	1,959,830	2,080,323
Other assets	1,551,996	1,322,499
Total assets	$ 81,827,111	$ 78,407,571
Liabilities and Shareholders' Equity		
Borrowings	$ 348,653	$ 547,952
Trust preferred capital notes	10,310,000	15,465,000
Other liabilities	558,931	570,596
Shareholders' equity	70,609,527	61,824,023
Total liabilities and shareholders' equity	$ 81,827,111	$ 78,407,571

Statements of Income (Condensed)

	2014	2013
Income - Dividends from subsidiaries	$ 7,100,624	$ 2,353,952
Other	1,447,433	1,375,978
Total income	$ 8,548,057	$ 3,729,930
Expenses - Interest expense	$ 276,010	$ 314,768
Other expenses	1,000,560	841,697
Total expenses	$ 1,276,570	$ 1,156,465
Income before income taxes and equity in undistributed earnings of subsidiaries	$ 7,271,487	$ 2,573,465
Allocated income tax expense	(114,830)	(138,934)
Income before equity in undistributed earnings of subsidiaries	$ 7,156,657	$ 2,434,531
Equity in (distributed) undistributed earnings of subsidiaries	(622,790)	4,918,522
Net income	$ 6,533,867	$ 7,353,053

Statements of Cash Flows (Condensed)

	2014	2013
Cash Flows from Operating Activities		
Net income	$ 6,533,867	$ 7,353,053
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	136,001	181,320
Equity in distributed (undistributed) earnings of subsidiaries	622,790	(4,918,522)
Issuance of common stock for services	90,423	99,333
Gain on sale of securities	—	(1,081,127)
Gain on redemption of trust preferred capital note	(1,100,000)	—
Stock-based compensation	259,874	134,774
Release of ESOP shares	218,419	216,788
Changes in other assets and liabilities:		
(Increase) in other assets	(228,957)	(280,763)
Increase (decrease) in other liabilities	(49,964)	110,750
Net cash provided by operating activities	$ 6,482,453	$ 1,815,606
Cash Flows from Investing Activities		
Purchases of premises and equipment	$ (15,508)	$ (3,994)
Proceeds from sales and calls of securities available for sale	—	1,081,127
Net cash provided by investing activities	$ (15,508)	$ 1,077,133
Cash Flows from Financing Activities		
Dividends paid	$ (1,790,788)	$ (1,668,984)
Curtailment of borrowings	(199,299)	(746,046)
Repurchase of common stock	(601,512)	(1,137,819)
Redemption of trust preferred securities	(4,055,000)	—
Exercise of stock options	333,985	979,003
Net cash (used in) financing activities	$ (6,312,614)	$ (2,573,846)
Net increase in cash	$ 154,331	$ 318,893
Cash at beginning of year	990,990	672,097
Cash at end of year	$ 1,145,321	$ 990,990

Yount Hyde & Barbour
Certified Public Accountants
and Consultants

Culpeper Leesburg Middleburg Richmond Winchester

To the Board of Directors and Shareholders
Chesapeake Financial Shares, Inc.
Kilmarnock, Virginia

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Chesapeake Financial Shares, Inc. and its Subsidiaries which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Chesapeake Financial Shares, Inc. and its Subsidiaries as of December 31, 2014 and 2013, 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.

Winchester, Virginia
February 19, 2015

Yount, Hyde & Barbour, P.C.

Financial Overview: Chesapeake Financial Shares, Inc. posted earnings of $6,533,867 for 2014. The return on average equity in 2014 was 10.4% and return on average assets was 1% compared to 13% and 1.1%, respectively, in 2013. At the end of 2014, Chesapeake Financial Shares, Inc. (CFS) had total assets of $663 million which was flat when compared to December 31, 2013. The Company ended the year with total gross loans of $391.7 million, and total deposits of $562.7 million, up 2.9% and down 1.7%, respectively.

The current economic environment continued to cause soft loan demand coupled with competitive pricing pressures. Despite the pressures mentioned, loan volume was up $11 million for 2014 which brought the average annual loan growth rate for the last five years to 1.4%. Total past due and nonaccrual loans decreased by $7,567,087 from 2013 to 2014. The loan loss reserve to gross loans less unearned discounts remained at an adequate level during 2014 of 1.6%. The deposit decrease of 1.7% for 2014 brought the average annual deposit growth rate for the last five years to 3%. The Holding Company and the Bank continued to maintain their "well capitalized" status, the highest ranking available from the Federal Deposit Insurance Corporation (FDIC).

Summary of Results of Operations: Earnings for 2014 were $6,533,867 or $1.62 per share (fully diluted) compared to $7,353,053 or $1.84 per share in 2013, a decrease of $819,186. The 11.5% decrease in net income resulted from a decrease in noninterest income and an increase in non-interest expense during 2014. Net interest income before the provision was relatively flat from 2013. There was a 6.4% decrease or $1,137,427 in noninterest income excluding other than temporary impairment (OTTI), and noninterest expense increased by 2.9% or $886,504 in 2014 over 2013. The loss for OTTI decreased by $206,653, or 35.9%. Merchant services income and Cash Management fee income decreased from the 2013 levels by $541,606 and $636,642 or 10.3% and 17.7%, respectively.

Earnings for 2013 were $7,353,053 or $1.84 per share (fully diluted) compared to $7,675,951 or $1.93 per share in 2012, a decrease of $322,898. The 4.2% decrease in net income resulted from an increase in the provision for loan losses of $533,336 or 89% from 2012.

Assets: Loan Portfolio: The loan portfolio is the largest component of earning assets for the Company and accounts for the greatest portion of total interest income. The gross loan portfolio totaled $391.7, $380.6, and $373.2 million for 2014, 2013, and 2012, respectively, representing an increase of 2.9% for 2014 from 2013, 2.0% for 2013 from 2012, and 4.9% for 2012 from 2011. Commercial, (including real estate and non-real estate combined), residential real estate, and consumer loan balances were up 2.6% or $7.5 million, 3.3% or $2.7 million and 9% or $.9 million, respectively.

On December 31, 2014, the loan portfolio consisted of 75.5% commercial loans, 21.7% single-family residential and residential construction loans, and 2.8% consumer and other loans. Commercial loans consisted primarily of business loans such as owner-occupied commercial development, retail, builders/contractors, medical, service and professional, hospitality, nonprofits, marine industry, and a small portion of agricultural and seafood loans.

Total nonperforming assets consisted of nonaccrual loans, performing restructured loans, repossessed and foreclosed properties, and Other Real Estate Owned. Nonperforming assets were $17,531,228 at December 31, 2014, which represented a 31.1% decrease from $25,442,177 at December 31, 2013. Past due loans over thirty days, excluding nonaccrual, were 0.7% of total loans at December 31, 2014. Nonaccrual loans were 2.2% of total loans at December 31, 2014. A significant portion of the nonperforming asset total is attributable to a group of loans that are included as a result of a reclassification of these credits based on the identification of some weakness. Any potential loss related to these loans has been incorporated in the allowance for loan losses.

Investment Securities: All of CFS's securities are classified as securities available for sale. Securities may be classified as investment securities (held to maturity) when management has the intent and CFS has the ability at the time of purchase to hold the securities to maturity. Investment securities are carried at cost adjusted for amortization of premiums and accretion of discounts. Securities available for sale include securities that may be sold in response to changes in market interest rates, changes in the securities option or credit risk, increases in loan demand, general liquidity needs and other similar factors. Securities available for sale are carried at fair market value.

The fair market value of the portfolio was $6,207,412 more than amortized cost, net of the tax effect at December 31, 2014, and was more than amortized cost by $2,466,124, net of the tax effect at December 31, 2013. This is within risk limits established by the Board and the Asset/Liability Management Committee.

At year-end, total securities at fair market value were $190.3 million, up $25.8 million from the $164.4 million on December 31, 2013. Investments in securities of state and political subdivisions increased by $15.9 million or 14.9%. Investments in mortgage backed securities increased by $9.9 million or 17.2%.

Asset Quality-Provision/Allowance for Loan Losses: The provision for loan losses is a charge against earnings necessary to maintain the allowance for loan losses at a level consistent with management's evaluation of the credit quality and risk adverseness of the loan portfolio. The allowance for loan losses represents management's estimate of the amount adequate to provide for potential losses inherent in the loan portfolio. To achieve this goal, the loan loss provision must be sufficient to cover loans charged off plus any growth in the loan portfolio and recognition of specific loan impairments. In determining the adequacy of the allowance for loan losses, management uses a methodology which specifically identifies and reserves for higher risk loans. A general reserve is established for nonspecifically reserved loans. Loans in a nonaccrual status and over ninety days past due are considered in this evaluation as well as other loans, which may be a potential loss. The status of nonaccrual and past due loans varies from quarter to quarter based on seasonality, local economic conditions, and the cash flow of customers.

The allowance for loan losses was $6,365,886 or 1.63% of gross loans less unearned discounts at year-end. This ratio was 1.66% on December 31, 2013, and 1.70% in 2012. The table below represents the provision for loan losses taken in years 2012 through 2014 as well as loans charged off and subsequent recoveries.

	2014	2013	2012
Provision for Loan Losses	$ 600,000	$ 1,133,336	$ 600,000
Loans Charged Off	675,830	1,172,056	763,771
Recoveries	117,812	10,835	54,935

Management and the Board of Directors believe that the total allowance at year-end was adequate relative to current levels of risk in the portfolio. However, continued loan growth or increases in specific problem loans may warrant additional provisions in the future.

Liabilities: Deposits: CFS depends on deposits to fund most of its lending activities, generate fee income opportunities, and create a market for other financial service products. Deposits are also the largest component of CFS's liabilities and account for the greatest portion of interest expense.

Deposits totaled $562.7, $572.4, and $564.2 million for 2014, 2013, and 2012 respectively, and represented a decrease of 1.7% for 2014 over 2013 and an increase of 1.5% for 2013 over 2012. The below table represents a breakdown of total deposits.

	2014	2013	Change	Percent Change
Demand Deposits (non-interest bearing)	$ 126,017,403	$ 118,876,325	$ 7,141,078	6.0%
Savings & Interest Bearing Deposits	248,007,401	236,434,565	11,572,836	4.9%
Certificates of Deposit	188,696,300	217,094,273	(28,397,973)	-13.1%
Total Deposits	$ 562,721,104	$ 572,405,163	$ (9,684,059)	-1.69%

The Company has been able to attract and retain deposits through its online banking internet branch which offers internet-based retail checking, savings and certificate of deposit accounts. Through the use of its online branch, the Company has been able to attract deposits from all 50 states. The Company started the internet branch in 2009 and deposit balances peaked at approximately $50 million. At December 31, 2014, deposits totaled $29.8 million.

Net Interest Income: The principal source of earnings for CFS is net interest income. Net interest income is the difference between interest plus fees generated by earning assets and interest expense paid to fund those assets. As such, net interest income represents the gross profit from the Bank's lending, investment, and funding activities.

A large number of variables interact to affect net interest income. Included are variables such as changes in the mix and volume of earning assets and interest bearing liabilities, market interest rates, and the statutory federal tax rate. It is management's ongoing policy to maximize net interest income through the development of balance sheet and pricing strategies while maintaining appropriate risk levels as set by the board.

Net interest income totaled $23.1, $23.3, and $23.1 million for 2014, 2013, and 2012, respectively, representing a 0.8% decrease for 2014 over 2013, 1% increase for 2013 over 2012, and 1% for 2012 over 2011. Loan balances increased this year with total gross loans up 2.9% or $11.1 million for 2014 from 2013. Total interest expense was $3.5, $4.1, and $5.8 million for 2014, 2013, and 2012, respectively. On a tax equivalent annualized basis, the net interest margin was 4.6% for 2014, 2013, and 2012 respectively. The Bank's margins have been very stable and well above peer through numerous rate cycles and through the recent recession.

Noninterest Income: For the year ended December 31, 2014 noninterest income was $16.6 million excluding a charge of $369,200 for Other Than Temporary Impairment (OTTI) of investments. This represents a decrease in noninterest income of $1,137,427 for the year. Changes in noninterest income categories are highlighted below.

	2014	2013	Change	Percent Change
Merchant Discount Income	$ 4,743,700	$ 5,285,306	$ (541,606)	-10.2%
ATM Fee Income	1,148,725	1,129,865	18,860	1.7%
Asset Management Fees	854,645	880,322	(25,677)	-2.9%
Gain on redemption of trust preferred	1,100,000	—	1,100,000	100.0%
Other Income	2,183,332	2,640,481	(457,149)	-17.3%
Gains on Sale of Securities	176,673	952,682	(776,009)	-81.5%
Cash Management Fees	2,953,032	3,589,674	(636,642)	-17.7%
Service Charge Income	1,148,539	1,250,781	(102,242)	-8.2%
Trust Income	2,280,020	1,996,982	283,038	14.2%
Total Noninterest Income	$ 16,588,666	$ 17,726,093	$ (1,137,427)	-6.4%

Noninterest income represented 38% of the total gross revenue for the Company. Sources of noninterest income include the Company's merchant processing services (Chesapeake Payment Systems), accounts receivable financing (Cash Flow), wealth management and trust services (Chesapeake Investment Group) and mortgage origination sold to a secondary market. The Company was able to purchase and retire $5 million of its $15 million in outstanding trust preferred debt. Because our accepted bid of $3.9 million was less than the $5 million carrying value, the Company was able to recognize a gain of $1.1 million related to this transaction. As of December 31, 2014, $10 million of trust preferred debt was still outstanding.

Noninterest Expenses: Total noninterest expenses increased 2.9% or $886,504 in 2014 over 2013. In 2013, total noninterest expenses increased 7% over 2012. Occupancy expenses decreased $21,361 over 2013, while salary and benefit costs increased by $449,124 or 3.2%. Below is a breakdown of other expenses for 2014 over 2013.

	2014	2013	Change	Percent Change
Advertising	$ 809,853	$ 917,826	$ (107,973)	-11.8%
Software	942,508	969,296	(26,788)	-2.8%
Provision for cash management account losses	550,000	742,666	(192,666)	-25.9%
Delivery and transportation	233,442	220,647	12,795	5.8%
Stationery and supplies	370,074	390,504	(20,430)	-5.2%
Miscellaneous other	5,079,562	4,696,417	383,145	8.2%

Liquidity, Interest Rate Sensitivity, and Inflation: The objectives of CFS's liquidity management policy include providing adequate funds to meet the needs of depositors and borrowers at all times, as well as providing funds to meet the basic needs for ongoing operations of CFS, and to allow funding of longer-term investment opportunities and regulatory requirements. The objective of providing adequate funding should be accomplished at reasonable costs and on a timely basis. Management considers CFS's liquidity to be adequate.

The Bank's primary sources of asset liquidity continue to be federal funds purchased, time deposits with other banks, securities maturing within one year, loan curtailments, and short-term borrowings. On December 31, 2014, approximately 37.9% of total assets matured or were repricing within one year as compared to 48.7% on December 31, 2013. The Bank's loan portfolio was liquid with 45.3% of all loan dollars maturing or repricing within one year at December 31, 2013. The loan liquidity ratio was 53.2%% on December 31, 2013.

Other sources of asset liquidity include the normal amortization and prepayment of loans, sale of loans, and proceeds from the sale of repossessed assets and other real estate owned. The sale of loans through the secondary market operation enhances the liquidity position by providing both fixed and adjustable rate long-term mortgage options to our client base. Mortgage loans held for resale are stated at the lower of cost or market (or contract value), however, due to the quick turning of these assets, seldom do these loans represent more than 1% of total assets.

Bank management maintains overnight borrowing relationships with correspondent banks for up to $74 million, secured and unsecured. CFS has access to additional secured borrowing of $5 million.

As of December 31, 2014, the Bank held $2,701,337 in other real estate owned. These assets are being actively marketed through real estate channels and represent near term secondary sources of liquidity. The Company was able to dispose of $1,313,976, or 32.7%, of other real estate owned during 2014.

Since the assets and liabilities of a bank are primarily monetary in nature (payable in fixed, determinable amounts), the performance of a bank is affected more by changes in interest rates than by inflation. Interest rates generally increase as the rate of inflation increases, but the magnitude of the change in rates may not be the same. Interest rate sensitivity refers to the difference between assets and liabilities subject to repricing, maturity, or volatility during a specified period. Management's objective in controlling interest rate sensitivity is to reprice loans and deposits and make investments that will maintain a profitable net interest margin (see "Net Interest Income").

While the effect of inflation is normally not as significant as its influence on those businesses that have large investments in plant and inventories, it does have an effect. There are normally corresponding increases in the money supply, and banks will normally experience above average growth in assets, loans and deposits. Also, general increases in the prices of goods and services will result in increased operating expenses.

Shareholders' Equity: Capital represents funds, earned or obtained, over which management can exercise greater control in comparison with deposits and borrowed funds. Future growth and expansion of CFS is dictated by the ability to produce capital. The adequacy of CFS's capital is reviewed by management on an ongoing basis with reference to the size, composition and quality of CFS's asset and liability levels and consistent with regulatory requirements and industry standards. Management seeks to maintain a capital structure that assures an adequate level to support anticipated asset growth and absorb potential losses.

Federal regulators have adopted minimum capital standards. Specifically, the guidelines categorize assets and off balance sheet items into four risk-weighted categories. The minimum ratio of qualifying total capital to risk-weighted assets is 8%. For CFS, Tier 1 capital is composed of common equity and retained earnings. Tier 1 capital to risk-weighted assets and Tier 1 capital to average assets (called leveraged capital) must be 4%. On December 31, 2014, the Company had ratios of Tier 1 risk-based capital to risk-weighted assets of 14.7%, total risk-based capital to risk-weighted assets of 16%, and Tier 1 leverage capital of 11.2%. At December 31, 2013, these ratios were 14.3%, 15.5% and 11.2%, respectively. At December 31, 2014, these ratios for the bank only were 13.7%, 15%, and 10.5% respectively, well above the regulatory minimums and exceeded the requirements for FDIC's "well capitalized" designation.

Dividend and Market Information: The Company's stock trades on the "OTC" (Over the Counter) market under the symbol "CPKF." The Company has increased its dividend payment annually for more than twenty years. The Company raised its dividend to $0.45 per share in 2014, an increase of $0.025 over 2013. This increase followed a $0.05 per share dividend increase from $0.375 in 2012 to $0.425 in 2013. The Company also performed a 6-for-5 stock split during 2014. Per share information has been adjusted for the split. Trades in the Company's common stock occurred infrequently and generally involved a relatively small number of shares. Based on information available, the selling price for the Company's common stock during 2014 ranged from $14.08 to $16.04, and during 2013, from $13.97 to $16.64. Such transactions may not be representative of all transactions during the indicated periods of the fair value of the stock at the time of such transactions due to the infrequency of trades and the limited market for the stock. Management attributes the Company's ability to maintain stable share prices, during hard economic times, to its earnings over the past several years. At December 31, 2014, there were 3,985,926 shares of the Company's common stock outstanding held by approximately 215 holders of record.

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J. Stephen Wiseman

*Deceased

Kit was very dedicated to her husband and family. For 62 years, Doug was the love of her life, and together they raised five children and were blessed with sixteen grandchildren. Her family and friends enjoyed her spirit of hospitality, generosity and enthusiasm and were inspired by her example of faith, love and loyalty.

In Memory of
Katherine Willis "Kit" Monroe

On Wednesday, April 23, 2014, when Katherine Willis Monroe passed on, Chesapeake Financial Shares lost a great friend and very devoted supporter. Kit, as she was known to all, was born in Baltimore, Maryland. She attended Roland Park Country School in Baltimore, Maryland, and Hollins College, Roanoke, Virginia.

On September 3, 1954 she married Douglas D. Monroe, Jr. in Annapolis, Maryland.

In 1985 Kit was elected to serve on the Chesapeake Financial Shares Board of Directors and did so with distinction from 1985 to 2013 through her sincere respect for the Employees, Officers and Directors of CFS and her love of the communities which Chesapeake serves. With her steadfast support and continued attention to the financial welfare of Chesapeake, its customers and their communities, she helped Chesapeake through some difficult years to its firm position of financial leadership.

Kit was very dedicated to her husband and family. For 62 years, Doug was the love of her life, and together they raised five children and were blessed with sixteen grandchildren. Her family and friends enjoyed her spirit of hospitality, generosity and enthusiasm and were inspired by her example of faith, love and loyalty.

Over the years Kit was committed to living her faith. She was an active member of Campbell Memorial Presbyterian Church, Weems, and for the last 30 years, The Christian Science Society, Kilmarnock, and The Church of Christ Scientist, Boston. She loved her country and was an active supporter of the Virginia Republican Party. Kit was a founding patron of Chesapeake Academy, Irvington, and served as a supportive parent, grandparent, teacher and coach.

Chesapeake, her family, friends and the community miss her sincere, bright smile and touching presence.

CHESAPEAKE
FINANCIAL SHARES, INC.

Chesapeake Financial Shares, Inc.

Chesapeake Bank

Chesapeake Investment Group

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