



CHESAPEAKE

FINANCIAL SHARES INC.

IT'S ALL ABOUT COMMUNITY.

2015 ANNUAL REPORT

2015 by the Numbers

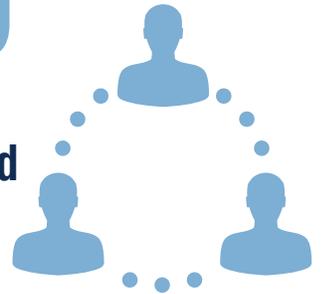


66

Organizations Served
by Our **Volunteers**

130

Employees
Volunteered



31 of those held officer positions

\$1.82 Earnings Per Share

10.08% Return on Equity



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

Top 50 Best Banks to Work For
and Top 200 Community Banks:
Ranked #34 in Nation

(based on three-year average ROE)

2015 designations by
AMERICAN BANKER®

Over
7,400
Volunteer Hours
in 2015



3,347

Small
Businesses
Served



Over
22,000

Customers
Served



2015 was a tremendous year for Chesapeake Financial Shares! I want to thank each of you as shareholders for your trust in our company both as an investor and key community partner. As a company, we do not take these responsibilities lightly.

As the following pages show, we have had very strong performance in an ambiguous economic environment. As noted in prior years' reports, our long-term diversification away from strictly traditional banking income is what has allowed us to continue to prosper in this economy.

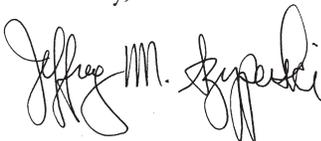
Our 2015 earnings were \$7,404,340, a significant increase over last year's earnings. Some of this increase was due to one-time gains we had the opportunity to realize, but core earnings remained strong while investing significant resources in new regions and lines of business to carry us forward.

In 2015 we were recognized for the eighth straight year by American Banker magazine as one of the "Top 200 Community Banks" in the country based on return on equity. This means we rank in the top banks in the nation on a key metric that delivers results for you, our shareholders.

As we pass through this life, we all leave our mark, some through humor, some through knowledge, some through sheer talent, and some through an eclectic mixture hard to quantify. Notable passings in 2015 include: Dean Smith, Leonard Nimoy, John Nash, B.B. King, Natalie Cole, Yogi Berra, Meadowlark Lemon, Dean Jones, Maureen O'Hara and Omar Sharif. Their contributions to our world were and continue to be significant.

Organizationally, we spent much of 2015 setting up a strong 2016, and we are excited about where our organization can go. Please plan on joining us Friday, April 1, at Rappahannock Westminister-Canterbury for our Annual Shareholders Meeting. It is a fun as well as educational event. We look forward to seeing you there!

Sincerely,



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

SELECTED FINANCIAL INFORMATION

	2015	2014	2013	2012	2011
	<i>(Dollars in thousands except ratios and per share amounts)</i>				
Results of Operations					
Interest income	\$ 26,801	\$ 26,651	\$ 27,415	\$ 28,866	\$ 29,779
Interest expense	3,378	3,533	4,121	5,811	6,962
Net interest income	23,423	23,118	23,294	23,055	22,817
Provision for loan losses	241	600	1,133	600	1,190
Net interest income after provision for loan losses	23,182	22,518	22,161	22,455	21,627
Noninterest income	20,108	16,219	17,150	15,417	14,160
Noninterest expense	34,405	31,048	30,162	28,172	26,908
Income before tax	8,885	7,689	9,149	9,700	8,879
Income tax expense	1,481	1,155	1,796	2,024	1,898
Net income	\$ 7,404	\$ 6,534	\$ 7,353	\$ 7,676	\$ 6,981
Financial Condition					
Total assets	\$ 679,058	\$ 663,186	\$ 662,992	\$ 667,718	\$ 637,953
Total deposits	565,553	562,721	572,405	564,234	543,579
Net loans	407,405	385,304	374,275	366,878	349,287
Long-term debt	10,247	10,390	10,527	23,709	24,235
Short-term debt	15,803	—	—	—	—
Trust preferred capital notes	5,155	10,310	15,465	15,465	15,465
Shareholders' equity	75,957	70,610	61,824	60,909	51,225
Average assets	667,260	661,669	655,170	643,079	619,905
Average shareholders' equity	73,473	62,981	56,790	51,612	45,463
Key Financial Ratios					
Return on average assets	1.11%	0.99%	1.12%	1.19%	1.13%
Return on average equity*	10.08%	10.37%	12.95%	14.87%	15.30%
Cash dividends paid as a percent of net income	25.16%	27.41%	22.70%	19.33%	18.5%
Per Share Data**					
Net income, assuming dilution	\$ 1.820	\$ 1.620	\$ 1.840	\$ 1.930	\$ 1.800
Cash dividends declared	\$ 0.47	\$ 0.45	\$ 0.425	\$ 0.375	\$ 0.330
Book value	\$ 18.92	\$ 17.71	\$ 15.63	\$ 15.67	\$ 13.06

*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.

CONSOLIDATED BALANCE SHEETS

December 31,

	2015	2014
Assets		
Cash and due from banks	\$ 11,734,624	\$ 13,677,321
Interest-bearing deposits in banks	3,069,202	12,987,575
Securities available for sale, at fair value	186,372,385	190,299,243
Restricted stock, at cost	2,677,400	2,286,600
Loans held for sale	578,000	150,000
Loans, net of allowance for loan losses of \$5,488,068 in 2015 and \$6,365,886 in 2014	407,404,583	385,304,316
Premises and equipment, net	18,724,375	17,256,039
Accrued interest receivable	2,737,675	2,922,375
Cash management accounts, net of allowance of \$1,158,749 in 2015 and \$1,347,864 in 2014	24,338,473	17,185,969
Foreclosed assets, net of allowance of \$809,861 in 2015 and \$822,629 in 2014	2,078,493	2,701,337
Bank-owned life insurance	11,069,462	10,764,759
Other assets	8,273,480	7,650,696
Total assets	\$ 679,058,152	\$ 663,186,230
Liabilities and Shareholders' Equity		
Deposits:		
Demand accounts	\$ 138,987,307	\$ 126,017,403
Savings and interest-bearing demand deposits	253,318,726	248,007,401
Certificates of deposit		
Denominations less than \$250,000	150,607,379	166,035,241
Denominations of \$250,000 or more	22,639,319	22,661,059
Total deposits	\$ 565,552,731	\$ 562,721,104
Trust preferred capital notes	5,155,000	10,310,000
Long-term debt	10,247,464	10,390,339
Short-term debt	15,803,000	—
Accrued interest payable	104,188	148,264
Accrued expenses and other liabilities	6,238,610	9,006,946
Total liabilities	\$ 603,100,993	\$ 592,576,653
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 4,015,233 in 2015 and 3,985,926 in 2014 (including 60,960 in 2015 and 49,380 in 2014 nonvested shares)	19,771,365	19,682,730
Common stock, nonvoting, par value \$5 per share; authorized 635,000 shares; no shares outstanding	—	—
Additional paid-in capital	834,401	389,534
Retained earnings	49,746,710	44,468,303
Unearned ESOP shares	—	(138,400)
Accumulated other comprehensive income	5,604,683	6,207,410
Total shareholders' equity	\$ 75,957,159	\$ 70,609,577
Total liabilities and shareholders' equity	\$ 679,058,152	\$ 663,186,230

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

CONSOLIDATED STATEMENTS OF INCOME

	<i>Years Ended December 31,</i>	
	2015	2014
Interest and Dividend Income		
Interest and fees on loans	\$ 20,552,863	\$ 20,491,697
Interest on interest-bearing deposits and federal funds sold	16,129	17,938
Interest and dividends on securities available for sale:		
Taxable	2,094,143	2,127,963
Nontaxable	4,030,393	3,927,903
Dividends	107,174	85,048
Total interest and dividend income	\$ 26,800,702	\$ 26,650,549
Interest Expense		
Savings and interest-bearing accounts	\$ 625,863	\$ 594,445
Certificates of deposit	2,294,412	2,335,862
Short-term borrowings and FHLB advances	350,727	340,373
Long-term debt and trust preferred capital notes	106,918	262,790
Total interest expense	\$ 3,377,920	\$ 3,533,470
Net interest income	\$ 23,422,782	\$ 23,117,079
Provision for loan losses	241,341	600,000
Net interest income after provision for loan losses	\$ 23,181,441	\$ 22,517,079
Noninterest Income		
Trust income	\$ 2,223,701	\$ 2,280,020
Service charges	1,319,600	1,148,539
Net gain on sales of securities available for sale	1,186,691	176,673
Net other-than-temporary impairment losses on investments recognized in earnings (includes total other- than-temporary impairment losses of \$565,819 and \$435,219, net of \$30,055 and \$66,019 recognized in other comprehensive income before taxes)	(535,764)	(369,200)
Other income	15,914,339	12,983,434
Total noninterest income	\$ 20,108,567	\$ 16,219,466
Noninterest Expenses		
Salaries and benefits	\$ 16,636,703	\$ 14,587,482
Occupancy expenses	3,641,948	3,360,242
Net loss on other real estate owned	267,171	534,935
Other expenses	13,859,137	12,565,434
Total noninterest expenses	\$ 34,404,959	\$ 31,048,093
Income before income taxes	\$ 8,885,049	\$ 7,688,452
Income tax expense	1,480,709	1,154,585
Net income	\$ 7,404,340	\$ 6,533,867
Earnings per common share, basic	\$ 1.85	\$ 1.65
Earnings per common share, diluted	\$ 1.82	\$ 1.62

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	<i>Years Ended December 31,</i>	
	2015	2014
Net income	\$ 7,404,340	\$ 6,533,867
Other comprehensive income (loss):		
Unrealized holding gains (losses) on securities available for sale, net of tax expense (benefit) of (\$89,181) and \$1,861,870	\$ (173,115)	\$ 3,614,218
Reclassification adjustment, net of income tax expense (benefit) of \$221,315 and (\$65,459)	(429,612)	127,068
Other comprehensive income (loss), net of tax	\$ (602,727)	\$ 3,741,286
Comprehensive income	\$ 6,801,613	\$ 10,275,153

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	<i>Years Ended December 31,</i>	
	2015	2014
Cash Flows from Operating Activities		
Net income	\$ 7,404,340	\$ 6,533,867
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,651,054	1,619,436
Provision for loan losses	241,341	600,000
Provision for cash management account losses	225,000	550,000
Deferred income tax expense (benefit)	92,086	(653,142)
Amortization of premiums, net	1,638,022	1,589,029
Net gain on securities available for sale	(1,186,691)	(176,673)
Gain on redemption of trust preferred capital note	(1,100,000)	(1,100,000)
Net other-than-temporary impairment losses	535,764	369,200
Net loss on foreclosed assets	267,171	534,935
Stock-based compensation	429,282	259,874
Release of ESOP shares	196,068	218,419
Origination of loans available for sale	(25,633,080)	(15,261,635)
Proceeds from sale of loans available for sale	25,695,473	15,383,467
Gain on sale of loans	(490,393)	(271,832)
Issuance of common stock for services	95,342	90,423
Changes in other assets and liabilities:		
Decrease (increase) in accrued interest receivable	184,700	(184,522)
(Increase) decrease in other assets	(907,841)	2,405,119
Decrease in accrued interest payable	(44,076)	(35,633)
(Decrease) increase in other liabilities	(2,768,336)	6,420,656
Net cash provided by operating activities	\$ 6,525,226	\$ 18,890,988
Cash Flows from Investing Activities		
Purchases of securities available for sale	\$ (40,012,601)	\$ (47,633,141)
Proceeds from sales and calls of securities available for sale	17,835,097	6,276,852
Proceeds from maturities and paydowns of securities available for sale	24,204,044	18,679,684
Purchase of restricted stock, net	(390,800)	(413,200)
Proceeds from sale of foreclosed assets	738,214	1,705,153
Net increase in loans	(22,724,149)	(12,555,636)
Net (increase) decrease in cash management accounts	(7,377,504)	1,984,603
Other capital expenditures	(2,920,626)	(3,121,219)
Net cash used in investing activities	\$ (30,648,325)	\$ (35,076,904)

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	<i>Years Ended December 31,</i>	
	2015	2014
Cash Flows from Financing Activities		
Net increase in demand accounts, interest-bearing demand accounts and savings accounts	\$ 18,281,229	\$ 18,713,914
Net decrease in certificates of deposits	(15,449,602)	(28,397,973)
Exercise of stock options	412,337	333,985
Repurchase of common stock	(724,083)	(601,512)
Cash dividends	(1,862,977)	(1,790,788)
Net increase in federal funds purchased	5,803,000	—
Proceeds from issuance of short-term debt	10,000,000	—
Curtailement of long-term debt and redemption of trust preferred securities	(4,197,875)	(5,292,121)
Net cash provided by (used in) financing activities	\$ 12,262,029	\$ (17,034,495)
Net decrease in cash and cash equivalents	\$(11,861,070)	\$(33,220,411)
Cash and cash equivalents at beginning of year	26,664,896	59,885,307
Cash and cash equivalents at end of year	\$ 14,803,826	\$ 26,664,896
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for:		
Interest	\$ 3,421,995	\$ 3,569,103
Income taxes	\$ 1,652,500	\$ 684,377
Supplemental Schedule of Noncash Investing and Financing Activities		
Unrealized (loss) gain on securities available for sale	\$ (913,223)	\$ 5,668,615
Other real estate acquired in settlement of loans	\$ 382,541	\$ 926,112

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Years Ended December 31, 2015 and 2014

	Common Stock, Voting	Additional Paid-In Capital	Retained Earnings	Unearned ESOP Shares	Accumulated Other Comprehensive Income	Total
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
Net income	—	—	7,404,340	—	—	7,404,340
Other comprehensive loss	—	—	—	—	(602,727)	(602,727)
Exercise of stock options	184,845	227,492	—	—	—	412,337
Vesting of Restricted Stock	98,600	(98,600)	—	—	—	—
Release of ESOP shares	—	57,668	—	138,400	—	196,068
Issuance of common stock for services	30,835	64,507	—	—	—	95,342
Repurchase of common stock	(225,645)	(235,482)	(262,956)	—	—	(724,083)
Amortization of Restricted Stock	—	420,527	—	—	—	420,527
Stock-based compensation	—	8,755	—	—	—	8,755
Cash dividends (\$0.465 per share)	—	—	(1,862,977)	—	—	(1,862,977)
Balance, December 31, 2015	\$ 19,771,365	\$ 834,401	\$ 49,746,710	\$ —	\$ 5,604,683	\$ 75,957,159

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 19, 2016, 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:

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.

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.

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.

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 collectability 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, interest bearing deposits, 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 periods, 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 or 2015.

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 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. The adoption of the new guidance did not have a material impact on the Company's 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 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. The Company 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. A reporting entity may apply the amendments prospectively. A reporting entity also may apply the amendments retrospectively to all prior periods presented in the financial statements. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company does not expect the adoption of ASU 2015-01 to have a material impact on its consolidated financial statements.

In February 2015, the FASB issued ASU No. 2015-02, “Consolidation (Topic 810): Amendments to the Consolidation Analysis.” The amendments in this ASU are intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). In addition to reducing the number of consolidation models from four to two, the new standard simplifies the FASB Accounting Standards Codification™ and improves current GAAP by placing more emphasis on risk of loss when determining a controlling financial interest, reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a variable interest entity (VIE), and changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs. 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 is permitted, including adoption in an interim period. ASU 2015-02 may be applied retrospectively in previously issued financial statements for one or more years with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated. The Company does not expect the adoption of ASU 2015-02 to have a material impact on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, “Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs.” The amendments in this ASU are intended to simplify the presentation of debt issuance costs. These amendments require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments in this ASU are effective for public business entities for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for financial statements that have not been previously issued. The Company does not expect the adoption of ASU 2015-03 to have a material impact on its consolidated financial statements.

In August 2015, the FASB issued ASU No. 2015-14, “Revenue from Contracts with Customers (Topic 606): Deferral of Effective Date.” The amendments in ASU 2015-14 defer the effective date of ASU 2014-09 for all entities by one year. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. All other entities should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. All other entities may apply the guidance in ASU 2014-09 earlier as of an annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period. All other entities also may apply the guidance in ASU 2014-09 earlier as of an annual

reporting period beginning after December 15, 2016, and interim reporting periods within annual reporting periods beginning one year after the annual reporting period in which the entity first applies the guidance in ASU 2014-09. The Company does not expect the adoption of ASU 2015-14 (or ASU 2014-09) to have a material impact on its consolidated financial statements.

In August 2015, the FASB issued ASU 2015-15, “Interest – Imputation of Interest (Subtopic 835-30) – Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements (Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting).” On April 7, 2015, the FASB issued ASU 2015-03, Interest — Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, which requires entities to present debt issuance costs related to a recognized debt liability as a direct deduction from the carrying amount of that debt liability. The guidance in ASU 2015-03 (see paragraph 835-30-45-1A) does not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. Given the absence of authoritative guidance within ASU 2015-03 for debt issuance costs related to line-of-credit arrangements, the SEC staff stated that they would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. ASU 2015-15 adds these SEC comments to the “S” section of the Codification. The adoption of ASU 2015-15 did not have a material impact on our consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” The amendments in ASU 2016-01, among other things: 1) Requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. 2) Requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. 3) Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). 4) Eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently assessing the impact that ASU 2016-01 will have on its consolidated financial statements.

Note 2. Securities

Amortized cost and fair values of securities available for sale as of December 31, 2015 and 2014, are as follows:

	2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Securities of state and political subdivisions	\$ 114,778,856	\$ 7,048,354	\$ (126,780)	\$ 121,700,430
Mortgage-backed securities	63,101,584	1,941,884	(371,513)	64,671,955
Total	\$ 177,880,440	\$ 8,990,238	\$ (498,293)	\$ 186,372,385

	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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The amortized cost and fair value of securities available for sale as of December 31, 2015, 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	\$ 13,774,041	\$ 13,853,038
Due after one year through five years	98,403,439	103,563,805
Due after five years through ten years	58,903,194	61,554,326
Due after ten years	6,799,766	7,401,216
Total	\$ 177,880,440	\$ 186,372,385

Proceeds from sales and calls of securities available for sale during 2015 and 2014 were \$17,835,097 and \$6,276,852, respectively. Gross realized gains amounted to \$1,187,124 and \$176,673 in 2015 and 2014. Gross realized losses amounted to \$433 and \$0 in 2015 and 2014, respectively. The tax provision applicable to these net realized gains amounted to \$403,475 and \$60,069 in 2015 and 2014, 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 \$89,204,106 and \$82,161,174 at December 31, 2015 and 2014, respectively.

Temporarily Impaired Securities

Information pertaining to securities with gross unrealized losses at December 31, 2015 and 2014, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	2015			
	Less Than 12 Months		12 Months or More	
	Fair Value	Unrealized (Loss)	Fair Value	Unrealized (Loss)
Securities of state and political subdivisions	\$ 4,717,708	\$ (48,162)	\$ 1,890,706	\$ (78,618)
Mortgage-backed securities	23,856,706	(234,967)	9,003,165	(136,546)
	\$ 28,574,414	\$ (283,129)	\$ 10,893,871	\$ (215,164)

	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)

Securities of State and Political Subdivisions

CFS's unrealized losses on investments in eight 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, 2015.

Mortgage-Backed Securities

The unrealized losses on CFS's investment in 15 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, 2015.

The unrealized losses associated with 30 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, CFS has 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2014	\$ 2,782,805
Amount related to the credit loss for which an other-than-temporary impairment was not previously recognized	535,764
Realized losses	—
Ending balance as of December 31, 2015	\$ 3,318,569

Note 3. Loans

A summary of the balances of loans by segment follows:

	December 31,	
	2015	2014
Commercial - Non Real Estate	\$ 126,411,797	\$ 120,918,745
Commercial - Real Estate	190,940,844	174,767,809
Consumer - Non Real Estate	8,763,383	11,126,916
Residential - Real Estate	86,776,627	84,856,732
	\$ 412,892,651	\$ 391,670,202
Less: Allowance for loan losses	5,488,068	6,365,886
Loans, net	\$ 407,404,583	\$ 385,304,316

Overdrafts totaling \$96,903 and \$180,904 at December 31, 2015 and 2014, respectively, were reclassified from deposits to loans.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2015						
Balance beginning of year	\$ 3,024,750	\$ 1,676,206	\$ 311,237	\$ 1,353,693	\$ —	\$ 6,365,886
Provision for loan losses	(771,530)	1,293,325	(76,583)	(203,871)	—	241,341
Loans charged off	(262,996)	(661,171)	(185,918)	(302,253)	—	(1,412,338)
Recoveries on loans previously charged off	214,843	11,148	67,188	—	—	293,179
Total allowance for loan losses	\$ 2,205,066	\$ 2,319,509	\$ 115,924	\$ 847,569	\$ —	\$ 5,488,068
Individually evaluated for impairment	\$ 776,143	\$ 1,160,471	\$ 77,345	\$ 119,390	\$ —	\$ 2,133,349
Collectively evaluated for impairment	1,428,892	1,158,949	42,746	724,132	—	3,354,719
Total allowance for loan losses	\$ 2,205,035	\$ 2,319,420	\$ 120,091	\$ 843,522	\$ —	\$ 5,488,068
Individually evaluated for impairment	\$ 3,026,279	\$ 7,080,190	\$ 168,157	\$ 1,017,735	\$ —	\$ 11,292,361
Collectively evaluated for impairment	123,385,518	183,860,654	8,595,226	85,758,892	—	401,600,290
Total loans	\$ 126,411,797	\$ 190,940,844	\$ 8,763,383	\$ 86,776,627	\$ —	\$ 412,892,651
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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of information pertaining to impaired loans by class at December 31, 2015 and 2014:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2015					
With no related allowance:					
Commercial - Non Real Estate					
Secured	\$ 381,935	\$ 381,935	\$ —	\$ 533,921	\$ 25,800
Unsecured	—	—	—	—	—
Commercial - Real Estate					
Acquisition and development	398,610	398,610	—	420,529	30,583
Non-owner occupied	—	—	—	—	—
Owner occupied	651,643	651,643	—	1,415,895	29,131
Multifamily	—	—	—	—	—
Consumer - Non Real Estate					
Installment	70,411	70,411	—	65,551	4,137
Revolving	—	—	—	—	—
Other	—	—	—	—	—
Residential - Real Estate					
First Lien 1-4 Family	389,910	389,910	—	614,748	36,772
Junior Lien 1-4 Family	—	—	—	—	—
Construction	—	—	—	—	—
Land	228,325	228,325	—	183,015	6,725
Revolving	49,457	49,457	—	154,480	2,774
With an allowance recorded:					
Commercial - Non Real Estate					
Secured	\$ 2,421,070	\$ 3,040,994	\$ 552,869	\$ 4,674,237	\$ 37,213
Unsecured	223,274	223,274	223,274	251,422	6,109
Commercial - Real Estate					
Acquisition and development	—	—	—	—	—
Non-owner occupied	5,204,025	5,204,025	1,131,226	5,377,550	135,067
Owner occupied	825,912	825,912	29,245	883,007	47,111
Multifamily	—	—	—	—	—
Consumer - Non Real Estate					
Installment	96,800	96,800	76,399	100,706	5,969
Revolving	946	946	946	1,883	230
Other	—	—	—	—	—
Residential - Real Estate					
First Lien 1-4 Family	—	—	—	31,048	—
Junior Lien 1-4 Family	—	—	—	10,900	—
Construction	—	—	—	—	—
Land	—	—	—	12,001	—
Revolving	350,043	350,043	119,390	250,070	7,334
Total:					
Commercial - Non Real Estate	\$ 3,026,279	\$ 3,646,203	\$ 776,143	\$ 5,459,580	\$ 69,122
Commercial - Real Estate	7,080,190	7,080,190	1,160,471	8,096,981	241,892
Consumer - Non Real Estate	168,157	168,157	77,345	168,140	10,336
Residential - Real Estate	1,017,735	1,017,735	119,390	1,256,262	53,605
	\$ 11,292,361	\$ 11,912,285	\$ 2,133,349	\$ 14,980,963	\$ 374,955

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	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
	<u>\$ 17,137,545</u>	<u>\$ 17,137,545</u>	<u>\$ 2,876,471</u>	<u>\$ 15,217,307</u>	<u>\$ 1,057,356</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Included in impaired loans are troubled debt restructurings. At December 31, 2015 and 2014, \$7,831,042 and \$12,222,948 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 2015 or 2014.

There were no loans that subsequently defaulted (more than 90 days past due or charge-off) within the first year of modification during 2015 and 2014.

At December 31, 2015, no additional funds were 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	Total
December 31, 2015						
Commercial - Non Real Estate						
Secured	\$ 110,673,219	\$ 1,088,463	\$ 5,794,925	\$ 2,003,504	\$ —	\$ 119,560,111
Unsecured	6,602,566	—	28,373	220,747	—	6,851,686
Commercial - Real Estate						
Acquisition and development	23,233,717	1,700,000	—	398,611	—	25,332,328
Non-owner occupied	74,727,756	1,466,696	432,983	2,599,240	—	79,226,675
Owner occupied	70,629,987	563,750	6,268,717	1,274,134	—	78,736,588
Multifamily	5,232,977	—	2,412,277	—	—	7,645,254
Consumer - Non Real Estate						
Installment	6,364,978	5,461	324,099	162,126	5,084	6,861,748
Revolving	1,803,786	—	—	946	—	1,804,732
Other	96,903	—	—	—	—	96,903
Residential - Real Estate						
First Lien 1-4 Family	35,186,714	643,239	253,299	389,909	—	36,473,161
Junior Lien 1-4 Family	6,596,218	16,496	23,319	—	—	6,636,033
Construction	4,118,404	—	—	—	—	4,118,404
Land	7,140,885	46,353	15,537	228,324	—	7,431,099
Revolving	30,657,460	198,679	862,290	195,399	204,101	32,117,929
Total	\$ 383,065,570	\$ 5,729,137	\$ 16,415,819	\$ 7,472,940	\$ 209,185	\$ 412,892,651
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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2015							
Commercial - Non Real Estate							
Commercial Secured	\$ 24,977	\$ —	\$ —	\$ 24,977	\$ 2,223,504	\$ 117,311,630	\$ 119,560,111
Commercial Unsecured	—	—	—	—	222,722	6,628,964	6,851,686
Commercial Real Estate							
Commercial A&D	—	—	—	—	398,611	24,933,717	25,332,328
Commercial Non-Owner Occupied	292,515	—	—	292,515	2,599,240	76,334,920	79,226,675
Commercial Owner Occupied	294,334	91,993	—	386,327	1,069,319	77,280,942	78,736,588
Multifamily Commercial	—	—	—	—	199,997	7,445,257	7,645,254
Consumer - Non Real Estate							
Consumer Installment	1,747	—	—	1,747	44,523	6,815,478	6,861,748
Consumer Revolving	—	—	—	—	—	1,804,732	1,804,732
Consumer Other	10,254	—	—	10,254	—	86,649	96,903
Residential - Real Estate							
First Lien 1-4 Family	140,085	113,237	—	253,322	390,572	35,829,267	36,473,161
Junior Lien 1-4 Family	—	—	—	—	—	6,636,033	6,636,033
Construction	10,103	16,496	—	26,599	13,216	4,078,589	4,118,404
Land 35,160	—	—	35,160	274,678	7,121,261	7,431,099	—
Revolving	150,441	41,083	—	191,524	583,928	31,342,477	32,117,929
Total	\$ 959,616	\$ 262,809	\$ —	\$ 1,222,425	\$ 8,020,310	\$ 403,649,916	\$ 412,892,651
December 31, 2014							
Commercial - Non Real Estate							
Commercial Secured	\$ 180,252	\$ 20,712	\$ —	\$ 200,964	\$ 6,063,260	\$ 106,471,580	\$ 112,735,804
Commercial Unsecured	5,500	—	—	5,500	74,619	8,102,822	8,182,941
Commercial Real Estate							
Commercial A&D	—	—	—	—	453,726	23,608,273	24,061,999
Commercial Non-Owner Occupied	—	—	—	—	187,878	64,039,170	64,227,048
Commercial Owner Occupied	976,156	—	—	976,156	307,120	77,398,223	78,681,499
Multifamily Commercial	—	—	—	—	—	7,797,263	7,797,263
Consumer - Non Real Estate							
Consumer Installment	4,862	—	—	4,862	51,131	9,138,335	9,194,328
Consumer Revolving	—	—	—	—	—	1,751,684	1,751,684
Consumer 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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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,	
	2015	2014
Land	\$ 4,790,653	\$ 4,790,653
Buildings	18,208,511	15,846,591
Furniture, fixtures and improvements	2,090,205	2,240,749
Mechanical equipment	6,485,020	7,372,569
Leasehold improvements	3,984,123	4,081,534
	\$ 35,558,512	\$ 34,332,096
Less accumulated depreciation	16,834,137	17,076,057
	\$ 18,724,375	\$ 17,256,039

For the years ended December 31, 2015 and 2014, depreciation expense was \$1,452,290 and \$1,442,057, respectively.

Note 5. Borrowings

The Company's line of credit with the FHLB can equal up to 3% of total assets of the Bank. As of December 31, 2015, loans with a carrying value of \$21,959,116 and securities with an amortized cost of \$16,312,603 were pledged to the FHLB as collateral for borrowings. The FHLB line of credit totaled \$132.2 million with approximately \$32.6 million available at December 31, 2015. Additional loans are available that can be pledged as collateral for future borrowings from the FHLB above the current lendable collateral value. As of December 31, 2015, CFS had fixed-rate, short-term borrowings of \$10,000,000 outstanding with the FHLB. These short-term advances mature in January 2016 and had an interest rate of .40%. Long-term advances from the FHLB totaled \$10,101,545 as of December 31, 2015. The interest rates on long-term advances from the FHLB ranged from 1% to 3.435% with a weighted average interest rate of 3.30% as of December 31, 2015. CFS also borrowed \$1,000,000 from an unrelated entity at 1% to fund a local non-profit project. The remaining balance at December 31, 2015 for this borrowing was \$101,545. The note payable is secured by a deed of trust on property located in Lancaster County, Virginia with a carrying value of approximately \$675,000. CFS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

maintains an additional secured line of credit with another correspondent bank totaling \$5 million, of which there was no balance outstanding as of December 31, 2015. Details of long-term debt outstanding as of December 31, 2015 are as follows:

	Rate	Maturity Date	Amount
FHLB fixed rate advance	3.435%	5/7/2018	\$ 5,000,000
FHLB fixed rate advance	3.210%	7/3/2018	5,000,000
FHLB edge advance	1.000%	2/13/2017	101,545
Note payable	5.500%	1/1/2018	145,919
Total long-term debt			\$ 10,247,464

Aggregate maturities of all outstanding long-term debt as of December 31, 2015 are: 2016, \$148,893; 2017, \$92,411; 2018, \$10,006,160.

In addition to the available credit from the FHLB, CFS also has unsecured lines of credit with correspondent banks totaling \$54,000,000 available for overnight borrowings and a line of credit secured by 400,000 shares of CFS common stock with a correspondent bank totaling \$5,000,000 available for borrowing as of December 31, 2015.

Note 6. Income Taxes

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

	December 31,	
	2015	2014
Deferred tax assets:		
Allowance for loan and cash management account losses	\$ 2,259,918	\$ 2,622,675
Other real estate	275,353	279,694
Deferred compensation	29,352	39,440
Premises and equipment	63,369	198,646
Restricted stock	139,529	45,859
AMT tax credit carryforward	388,058	252,491
Other	279,907	88,767
	\$ 3,435,486	\$ 3,527,572
Deferred tax liabilities:		
Securities available for sale	\$ 2,887,262	\$ 3,197,756
Net deferred tax assets	\$ 548,224	\$ 329,816

The provision for income taxes charged to operations for the years ended December 31, 2015 and 2014, consists of the following:

	2015	2014
Current tax expense	\$ 1,388,623	\$ 1,807,727
Deferred tax	92,086	(653,142)
	\$ 1,480,709	\$ 1,154,585

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, 2015 and 2014, due to the following:

	2015	2014
Computed "expected" tax expense	\$ 3,020,917	\$ 2,614,074
(Decrease) increase in income taxes resulting from:		
Tax exempt income	(1,627,530)	(1,578,148)
Other	87,322	118,659
	\$ 1,480,709	\$ 1,154,585

CFS, on a consolidated basis, files income tax returns in the U.S. federal jurisdiction, the Commonwealth of Virginia and other states where income is generated. With few exceptions, CFS is no longer subject to U.S. federal or state income tax examinations by tax authorities for years before 2012.

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. The liability remaining is \$86,328 and \$116,001 for years ended December 31, 2015 and 2014, respectively.

CFS funded the deferred compensation commitment through life insurance policies on the officer. The officer is currently receiving benefits under this plan. CFS recorded income of \$108,525 and \$109,089 for years ended December 31, 2015 and 2014 for increasing cash value of these policies.

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 was internally leveraged through a loan from the Bank to the ESOP. Certain ESOP shares were pledged as collateral for its debt. As the debt was repaid, shares were released from collateral and allocated to active employees, based on the proportion of debt service paid in the year. Shares pledged as collateral were deducted from shareholders' equity as unearned ESOP shares in the accompanying consolidated balance sheets. At December 31, 2015, no shares remained as collateral securing the note payable.

The note payable referred to in the preceding paragraph required annual principal payments plus interest at the prime interest rate adjusted annually with a floor of 5.50%. There are no future payments due for this note.

As shares were 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 were recorded as a reduction of retained earnings. Dividends on unallocated ESOP shares were recorded as a reduction of debt and accrued interest. ESOP compensation expense was \$766,526 and \$553,066 for the years ended December 31, 2015 and 2014, respectively (including \$196,068 and \$218,419 for the years ended December 31, 2015 and 2014 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 \$449,945 and \$414,516 for 2015 and 2014, respectively.

Note 8. Stock Option Plans

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 reserved 224,640 shares of voting common stock for issuance and expired on January 21, 2015. The compensation cost that has been charged against income for those plans related to stock options was \$8,755 and \$37,096 for the years ended December 31, 2015 and 2014, respectively. No income tax benefit was recognized in the income statement for stock option compensation for the years ended December 31, 2015 and 2014.

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 originally reserved 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 2015.

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. The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model. 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. There were no options granted during the years ended December 31, 2015 and 2014.

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, 2015 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	275,697	\$ 10.96		
Granted	—			
Exercised	(36,969)	11.15		
Expired and Forfeited	—	—		
Outstanding at end of year	238,728	10.94	3.5	\$ 1,531,281
Options exercisable, end of year	238,728	10.94	3.5	\$ 1,531,281

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, 2015. This amount changes based on changes in the market value of CFS's stock.

The total intrinsic value of options exercised during the year ended December 31, 2015 and 2014, was \$170,923 and \$197,748, respectively. As of December 31, 2015 there are no unrecognized compensation costs related to nonvested stock options granted under the plans. As of December 31, 2014, the total unrecognized compensation cost was \$39,930.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Nonvested restricted stock activity for the year ended December 31, 2015 is summarized in the following table:

	Shares	Weighted Average Grant Date Value
Nonvested at January 1, 2015	49,380	\$ 15.36
Granted	31,300	16.25
Vested	(19,720)	15.40
Expired and Forfeited	—	—
Nonvested at December 31, 2015	60,960	\$ 15.81

At December 31, 2015, there was \$95,776 in unrecognized compensation cost related to nonvested restricted stock granted under the 2005 Plan. This cost is expected to be recognized over the next seven months. At December 31, 2015, there was \$639,109 in unrecognized compensation cost related to nonvested restricted stock granted under the 2014 Plan. This cost is expected to be recognized over the next 28 months. Share based compensation expense for nonvested restricted stock totaled \$420,527 and \$222,778 during 2015 and 2014, respectively.

Note 9. Shareholders' Equity

During 2015 and 2014, CFS issued 6,167 shares and 6,262 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 2020. 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, 2015 are as follows:

Year Ending December 31,	
2016	\$ 123,172
2017	126,743
2018	130,419
2019	115,928
2020	115,534
Thereafter	62,515

Rent expense under operating leases aggregated \$386,058 and \$369,394 for the years ended December 31, 2015 and 2014, 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, 2015 and 2014, the aggregate amounts of daily average required balances were approximately \$1,585,000 and \$1,438,000, respectively. These reserve requirements were covered by internal holdings.

Note 11. Related Party Transactions

Officers, directors and their affiliates had borrowings of \$8,931,324 and \$9,015,105 at December 31, 2015 and 2014, respectively, with the Bank.

Changes in borrowings during 2015 were as follows:

Balance, December 31, 2014	\$ 9,015,105
Additions	639,269
Payments	(723,050)
Balance, December 31, 2015	\$ 8,931,324

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 \$1,449,896 and \$1,410,832 as of December 31, 2015 and 2014, respectively.

Note 12. Other Income and Expenses

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

	2015	2014
Cash management fees and discount	\$ 3,085,960	\$ 2,953,032
Merchant discount	7,207,155	4,743,700
ATM fee income	1,180,500	1,148,725
Asset management fees	1,044,769	854,645
Gain on redemption of trust preferred capital notes	1,100,000	1,100,000
Other (includes no items in excess of 1% of total revenue)	2,295,955	2,183,332
	\$ 15,914,339	\$ 12,983,434

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

	2015	2014
Advertising	\$ 815,140	\$ 809,853
Merchant card	4,652,863	2,645,388
Software	1,122,373	942,508
Provision for cash management account losses	225,000	550,000
Legal fees	862,777	1,088,535
FDIC assessments	483,666	846,070
Delivery and transportation	220,036	233,442
Stationery and supplies	377,955	370,074
Foreclosed asset expense	139,832	170,869
Net loss on sale of foreclosed asset	127,339	364,065
Other (includes no items in excess of 1% of total revenue)	4,832,156	4,544,630
	\$ 13,859,137	\$ 12,565,434

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. Shares related to unvested restricted stock grants are included in the weighted average number of common shares outstanding because the holders participate in non-refundable dividends and have voting rights during the vesting period. All shares have been retroactively restated to give effect to the stock split described in Note 9.

	2015	2014
Weighted average number of common shares, basic	3,994,157	3,950,444
Effect of dilutive stock options	81,993	80,586
Weighted average number of common shares and dilutive potential common stock used in diluted EPS	4,076,150	4,031,030

There were no antidilutive options for the years ended December 31, 2015 and 2014.

Note 14. Time Deposits

Remaining maturities on certificates of deposit are as follows:

2016	\$ 103,221,667
2017	16,118,223
2018	14,670,675
2019	5,305,965
2020	3,740,168
Thereafter	30,190,000
	\$ 173,246,698

The Bank obtains certain deposits through the efforts of third-party brokers. At December 31, 2015 and 2014, brokered deposits totaled \$36,754,000 and \$39,942,000, 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, 2015 and 2014, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount	
	2015	2014
	(in thousands)	
Commitments to grant loans	\$ 4,881	\$ 5,154
Unfunded commitments under lines of credit	128,791	108,961
Commercial and standby letters of credit	3,714	2,492

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 \$2,146,127 at December 31, 2015.

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 source 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, 2015 and 2014:

Description	Carrying Value	Fair Value Measurements at December 31, 2015 Using		
		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	\$ 121,700	\$ —	\$ 121,700	\$ —
Mortgage-backed securities	64,672	—	56,751	7,921
Description	Carrying Value	Fair Value Measurements at December 31, 2014 Using		
		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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following tables present the changes in Level 3 assets that are measured at fair value on a recurring basis for the years ended December 31, 2015 and 2014:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)					Balance as of December 31, 2015
	Balance as of January 1, 2015	Total Realized/Unrealized Gains (Losses) Included in			Transfers in and/or Out of Level 3	
		Net Income	Other Comprehensive Income	Purchases, Sales, Issuances, and Settlements, Net		
(in thousands)						
Mortgage-backed securities	\$ 7,857	\$ (536)	\$ (30)	\$ —	\$ 630	\$ 7,921

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

Assets Measured at Fair Value on a Nonrecurring Basis

Under certain circumstances, CFS makes adjustments to fair value for its 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, 2015 and 2014, for which a nonrecurring change in fair value has been recorded:

	Fair Value Measurements at December 31, 2015 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	\$ —	\$ —	\$ 6,987
Other real estate owned	—	—	2,078

	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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Fair Value Measurements at December 31, 2015

	Fair Value	Valuation Techniques	Unobservable Inputs	Weighted Average
Assets				
Commercial - Non Real Estate	\$ 1,868	Market comparables	Discount applied to market comparables ⁽¹⁾	29.4%
Commercial - Real Estate	4,868	Market comparables	Discount applied to market comparables ⁽¹⁾	19.9%
Residential Real Estate	231	Market comparables	Discount applied to market comparables ⁽¹⁾	34.1%
Consumer - Non Real Estate	20	Market comparables	Discount applied to market comparables ⁽¹⁾	79.1%
Total Impaired Loans	\$ 6,987			
<hr/>				
Other Real Estate Owned	\$ 2,078	Market comparables	Discount applied to market comparables ⁽¹⁾	17.2%
<hr/>				
Total	\$ 9,065			

⁽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, 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			
<hr/>				
Other Real Estate Owned	\$ 2,701	Market comparables	Discount applied to market comparables ⁽¹⁾	19.5%
<hr/>				
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.

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's 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 as a foreclosed asset expense on the consolidated statements of income.

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

	Carrying Value	Fair Value Measurements at December 31, 2015			Total Fair Value
		Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	
Financial assets:					
Cash and short-term investments	\$ 14,804	\$ 14,804	\$ —	\$ —	\$ 14,804
Securities available for sale	186,372	—	178,451	7,921	186,372
Restricted stock	2,677	—	—	2,677	2,677
Loans, net	407,405	—	410,267	6,987	417,254
Cash management accounts, net	24,338	—	24,338	—	24,338
Accrued interest receivable	2,738	—	2,738	—	2,738
Bank-owned life insurance	11,069	—	11,069	—	11,069
Financial liabilities:					
Deposits	\$ 565,553	\$ —	\$ 564,909	\$ —	\$ 564,909
Trust preferred capital notes	5,155	—	4,060	—	4,060
Long-term debt	10,247	—	10,843	—	10,843
Short-term debt	15,803	—	15,803	—	15,803
Accrued interest payable	104	—	104	—	104
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	—	386,537	11,295	397,832
Cash management accounts, net	17,186	—	17,186	—	17,186
Accrued interest receivable	2,922	—	2,922	—	2,922
Bank-owned life insurance	10,765	—	10,765	—	10,765
Financial liabilities:					
Deposits	\$ 562,721	\$ —	\$ 562,405	\$ —	\$ 562,405
Trust preferred capital notes	10,310	—	8,085	—	8,085
Long-term debt	10,390	—	11,289	—	11,209
Accrued interest payable	148	—	148	—	148

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.

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Capital amounts and ratios for December 31, 2014 are calculated using Basel I rules. Management believes as of December 31, 2015, the Company and Bank meet all capital adequacy requirements to which they are subject.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2015:						
Total Capital						
(to Risk Weighted Assets):						
Consolidated	\$ 81,793	15.2%	\$ 43,082	8.0%	N/A	
Chesapeake Bank	\$ 75,886	14.2%	\$ 42,728	8.0%	\$ 53,410	10.0%
Tier 1 Capital						
(to Risk Weighted Assets):						
Consolidated	\$ 75,146	14.0%	\$ 32,312	6.0%	N/A	
Chesapeake Bank	\$ 69,239	13.0%	\$ 32,046	6.0%	\$ 42,728	8.0%
Tier 1 Capital						
(to Average Assets):						
Consolidated	\$ 75,146	11.2%	\$ 26,848	4.0%	N/A	
Chesapeake Bank	\$ 69,239	10.4%	\$ 26,563	4.0%	\$ 33,204	5.0%
Common Equity Tier 1 Capital						
(to Risk Weighted Assets)						
Consolidated	\$ 75,146	13.1%	\$ 24,234	4.5%	N/A	
Chesapeake Bank	\$ 69,239	13.0%	\$ 24,034	4.5%	\$ 34,716	6.5%
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%

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, 2015 was 1.66%. The interest rate as of December 31, 2014 was 1.71 %. 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.

In January 2015, CFS was notified that \$5.0 million of the \$10.0 million remaining 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 bids totaling \$3.9 million for the securities which were accepted by the trustee and the transactions closed on February 5, 2015 and February 13, 2015. Because the accepted bids of \$3.9 million were less than the \$5.0 million carrying value, CFS recognized a gain of \$1.1 million related to the transactions, when these securities were redeemed.

As of December 31, 2015, \$5.0 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 19. Accumulated Other Comprehensive Income

Changes in each component of accumulated other comprehensive income for the years ended December 31, 2015 and 2014 were as follows:

	Net Unrealized Gains (Losses) on Securities, Net
Balance at December 31, 2014	\$ 6,207,410
Unrealized gains on securities available for sale, net of tax of (\$89,181)	(173,115)
Reclassification adjustment, net of tax of \$221,315	(429,612)
Balance at December 31, 2015	\$ 5,604,683
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

Details regarding reclassifications out of accumulated other comprehensive income for the years ended December 31, 2015 and 2014 were as follows:

Reclassifications Out of Accumulated Other Comprehensive Income for the Year Ended December 31, 2015:

Details about AOCI Components	Amount Reclassified from AOCI	Affected Line Item in the Consolidated Income Statement
Realized gain on sale of securities	\$ 1,186,691	Net gain on sales of securities available for sale
Other-than-temporary impairment on securities	(535,764)	Net other-than-temporary impairment losses on investments recognized in earnings
Income tax expense	(221,315)	Income tax benefit
Total reclassifications	\$ 429,612	Net of tax

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 expense
Total reclassifications	\$ (127,068)	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, 2015, the amount available for payment of additional dividends without prior regulatory approval from the Bank to the parent company is \$4,533,124 or 5.97% of consolidated net assets.

Balance Sheets (Condensed)

	December 31,	
	2015	2014
Assets		
Cash	\$ 1,522,343	\$ 1,145,321
Investment in subsidiaries	77,213,562	77,169,964
Premises and equipment, net	1,852,644	1,959,830
Other assets	1,134,728	1,551,996
Total assets	\$ 81,723,277	\$ 81,827,111
Liabilities and Shareholders' Equity		
Borrowings	\$ 145,919	\$ 348,653
Trust preferred capital notes	5,155,000	10,310,000
Other liabilities	465,199	558,881
Shareholders' equity	75,957,159	70,609,577
Total liabilities and shareholders' equity	\$ 81,723,277	\$ 81,827,111

Statements of Income (Condensed)

	2015	2014
Income: Dividends from subsidiaries	\$ 6,658,236	\$ 7,100,624
Other	1,508,629	1,447,433
Total income	\$ 8,166,865	\$ 8,548,057
Expenses: Interest expense	\$ 112,751	\$ 276,010
Other expenses	1,233,771	1,000,560
Total expenses	\$ 1,346,522	\$ 1,276,570
Income before income taxes and equity in undistributed earnings of subsidiaries	\$ 6,820,343	\$ 7,271,487
Allocated income tax expense	(79,172)	(114,830)
Income before equity in undistributed earnings of subsidiaries	\$ 6,741,171	\$ 7,156,657
Equity in undistributed (distributed) earnings of subsidiaries	663,169	(622,790)
Net income	\$ 7,404,340	\$ 6,533,867

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Statements of Cash Flows (Condensed)

	2015	2014
Cash Flows from Operating Activities		
Net income	\$ 7,404,340	\$ 6,533,867
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	136,843	136,001
Equity in (undistributed) distributed earnings of subsidiaries	(663,169)	622,790
Issuance of common stock for services	95,342	90,423
Gain on redemption of trust preferred capital note	(1,100,000)	(1,100,000)
Stock-based compensation	429,282	259,874
Release of ESOP shares	196,068	218,419
Changes in other assets and liabilities:		
Decrease (increase) in other assets	434,112	(228,957)
(Decrease) in other liabilities	(93,682)	(49,964)
Net cash provided by operating activities	\$ 6,839,136	\$ 6,482,453
Cash Flows from Investing Activities		
Purchases of premises and equipment	\$ (29,657)	\$ (15,508)
Net cash used in investing activities	\$ (29,657)	\$ (15,508)
Cash Flows from Financing Activities		
Dividends paid	(1,862,977)	\$ (1,790,788)
Curtailement of borrowings	(202,734)	(199,299)
Repurchase of common stock	(724,083)	(601,512)
Redemption of trust preferred securities	(4,055,000)	(4,055,000)
Exercise of stock options	412,337	333,985
Net cash used in financing activities	\$ (6,432,457)	\$ (6,312,614)
Net increase in cash	\$ 377,022	\$ 154,331
Cash at beginning of year	1,145,321	990,990
Cash at end of year	\$ 1,522,343	\$ 1,145,321



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, 2015 and 2014, 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 consolidated financial statements (collectively, financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 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 financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 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, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Winchester, Virginia
February 19, 2016

Yount, Hyde & Barbour, P.C.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Financial Overview: Chesapeake Financial Shares, Inc. posted earnings of \$7,404,340 for 2015. The return on average equity in 2015 was 10.1% and return on average assets was 1.1% compared to 10.4% and 1%, respectively, in 2014. At the end of 2015, Chesapeake Financial Shares, Inc. (CFS) had total assets of \$679 million which was up 2.4% when compared to December 31, 2014. The Company ended the year with total gross loans of \$412.9 million, and total deposits of \$565.5 million, up 5.4% and 0.5%, respectively.

The current economic environment continued to cause soft loan demand coupled with competitive pricing pressures. Despite the pressures mentioned, loan volume was up \$21 million for 2015 which brought the average annual loan growth rate for the last five years to 2.7%. Total past due and nonaccrual loans decreased by \$1,978,237 from 2014 to 2015. The loan loss reserve to gross loans less unearned discounts remained at an adequate level during 2015 of 1.3%. The deposit increase of 0.5% for 2015 brought the average annual deposit growth rate for the last five years to 1.8%. 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 2015 were \$7,404,340 or \$1.82 per share (fully diluted) compared to \$6,533,867 or \$1.62 per share in 2014, an increase of \$870,473. The 13.3% increase in net income resulted primarily from an increase in noninterest income offset by an increase in noninterest expenses during 2015. Net interest income before the provision for loan losses was up 1.3% from 2014. There was a 24.4% increase or \$4,055,665 in noninterest income excluding other than temporary impairment (OTTI), and noninterest expense increased by 10.8% or \$3,356,866 in 2015 over 2014. The loss for OTTI increased by \$166,564, or 45.1%. Merchant discount income and Cash Management fee income increased from the 2014 levels by \$2,463,455 and \$132,928 or 51.9% and 4.5%, respectively. Also, asset management fees increased \$190,124 in 2015 over 2014 or 22.2%. In addition to these factors, management also recognized gains on the sale of investment securities of \$1.2 million. A portion of the state and political subdivisions securities portfolio was sold and repositioned during 2015.

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 11.1% decrease in net income resulted largely from a decrease of merchant discount income of \$541,606 or 10.2% from 2013 along with a decrease in Cash Management fee income of \$636,642 or 17.7% from 2013.

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 \$412.9, \$391.7, and \$380.6 million for 2015, 2014, and 2013, respectively, representing an increase of 5.4% for 2015 from 2014, 2.9% for 2014 from 2013, and 2% for 2013 from 2012. Commercial, (including real estate and non-real estate combined), residential real estate, and consumer loan balances were up 7.3% or \$21.7 million, 2.3% or \$1.9 million and down 2.1% or \$2.3 million, respectively.

On December 31, 2015, the loan portfolio consisted of 76.9% commercial loans, 21% single-family residential and residential construction loans, and 2.1% 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 \$13,709,038 at December 31, 2015, which represented a 21.8% decrease from \$17,531,228 at December 31, 2014. Past due loans over thirty days, excluding nonaccrual, were 0.3% of total loans at December 31, 2015. Nonaccrual loans were 1.9% of total loans at December 31, 2015. 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The fair market value of the portfolio was \$5,604,683 more than amortized cost, net of the tax effect, at December 31, 2015, and was more than amortized cost by \$6,207,412, net of the tax effect, at December 31, 2014. This is within risk limits established by the Board and the Asset/Liability Management Committee.

At yearend, total securities at fair market value were \$186.4 million, down \$3.9 million from \$190.3 million on December 31, 2014. Investments in securities of state and political subdivisions decreased by \$832,142 or 0.7%. Investments in mortgage backed securities decreased by \$3 million or 4.6%.

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 \$5,488,068 or 1.33% of gross loans less unearned discounts at yearend. This ratio was 1.63% on December 31, 2014, and 1.66% in 2013. The table below represents the provision for loan losses taken in years 2013 through 2015 as well as loans charged off and subsequent recoveries.

	2015	2014	2013
Provision for Loan Losses	\$ 241,341	\$ 600,000	\$ 1,133,336
Loans Charged Off	1,412,337	675,830	1,172,056
Recoveries	293,178	117,812	10,835

Management and the Board of Directors believe that the total allowance at yearend 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 \$565.6, \$562.7, and \$572.4 million for 2015, 2014, and 2013 respectively, and represented an increase of 0.5% for 2015 over 2014 and a decrease of 1.7% for 2014 over 2013. The below table represents a breakdown of total deposits.

	2015	2014	Change	Percent Change
Demand Deposits (non-interest bearing)	\$ 138,987,307	\$ 126,017,403	\$ 12,969,904	10.3%
Savings & Interest Bearing Deposits	253,318,726	248,007,401	5,311,325	2.1%
Certificates of Deposit	173,246,698	188,696,300	(15,449,602)	-8.2%
Total Deposits	\$ 565,552,731	\$ 562,721,104	\$ 2,831,627	0.50%

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, 2015, deposits in the online banking internet branch totaled \$26.6 million. Rate sensitive deposits in the internet branch have left the Bank as a result of rate competition pressures in this market.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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 \$23.4, \$23.1, and \$23.3 million for 2015, 2014, and 2013, respectively, representing an increase of 1.3% for 2015 over 2014, 0.8% decrease for 2014 over 2013, and 1% increase for 2013 over 2012. Loan balances increased this year with total gross loans up 5.4% or \$21.2 million for 2015 from 2014. Total interest expense was \$3.4, \$3.5, and \$4.1 million for 2015, 2014, and 2013, respectively. On a consolidated tax equivalent annualized basis, the 2015 net interest margin was 4.47%. 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, 2015 noninterest income was \$20.6 million excluding a charge of \$535,764 for Other Than Temporary Impairment (OTTI) of investments. This represents an increase in noninterest income of \$4,055,655 for the year. Most of this increase is attributable to merchant discount income. Changes in noninterest income categories are highlighted below.

	2015	2014	Change	Percent Change
Merchant Discount Income	\$ 7,207,155	\$ 4,743,700	\$ 2,463,455	51.9%
ATM Fee Income	1,180,500	1,148,725	31,775	2.8%
Asset Management Fees	1,044,769	854,645	190,124	22.2%
Gain on redemption of trust preferred	1,100,000	1,100,000	—	0.0%
Other Income	2,295,955	2,183,332	112,623	5.2%
Gains on Sale of Securities	1,186,691	176,673	1,010,018	571.7%
Cash Management Fees	3,085,960	2,953,032	132,928	4.5%
Service Charge Income	1,319,600	1,148,539	171,061	14.9%
Trust Income	2,223,701	2,280,020	(56,319)	-2.5%
Total Noninterest Income	\$ 20,644,331	\$ 16,588,666	\$ 4,055,665	24.4%

Noninterest income represented 43.5% 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. In 2014 and 2015, the Company was able to purchase and retire \$5 million in outstanding trust preferred debt. Because the 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 each year related to this transaction. As of December 31, 2015, \$5 million of trust preferred debt was still outstanding.

Noninterest Expenses: Total noninterest expenses increased 10.8% or \$3.4 million in 2015 over 2014. In 2014, total noninterest expenses increased 2.9% or \$866,504 over 2013. Occupancy expenses increased \$281,706 over 2014 as the Bank opened a branch in the Patterson Avenue area of Richmond, Virginia. Salary and benefit costs increased by \$2.1 million or 14.1% as a result of several new hires during the year. Below is a breakdown of other expenses for 2015 over 2014.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

	2015	2014	Change	Percent Change
Advertising	\$ 815,140	\$ 809,853	\$ 5,287	0.7%
Merchant Card	4,652,863	2,645,388	2,007,475	75.9%
Software	1,122,373	942,508	179,865	19.1%
Provision for Cash Management Account Losses	225,000	550,000	(325,000)	-59.1%
Legal Fees	862,777	1,088,535	(225,758)	-20.7%
FDIC Assessments	483,666	846,070	(362,404)	-42.8%
Delivery and Transportation	220,036	233,442	(13,406)	-5.7%
Stationery and Supplies	377,955	370,074	7,881	2.1%
Foreclosed Asset Expense	139,832	170,869	(31,037)	-18.2%
Net Loss on Sale of Foreclosed Asset	127,339	364,065	(236,726)	-65.0%
Miscellaneous Other	4,832,156	4,544,630	287,526	6.3%
Total Other Noninterest Expenses	\$ 13,859,137	\$ 12,565,434	\$ 1,293,703	10.3%

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, 2015, approximately 35.8% of total assets matured or were repricing within one year as compared to 37.9% on December 31, 2014.

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 the Company's 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 \$91.6 million, secured and unsecured. CFS has access to additional secured borrowing of \$5 million.

As of December 31, 2015, the Bank held \$2,078,493 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 a number of other real estate owned properties during 2015.

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.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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.

Regulators have adopted minimum capital standards. The table below represents CFS' consolidated capital ratios as of December 31, 2015 to Well Capitalized Prompt Corrective Action regulatory thresholds. In 2015 a new capital ratio was implemented by regulators, the Common Equity Tier 1 Capital to Risk Weighted Assets ratio. Common Equity Tier 1 capital is comprised of common stock, retained earnings, and qualifying minority interests- less applicable regulatory adjustments and deductions.

	2015	Well Capitalized Under Prompt Corrective Action	Variance
Total Capital to Risk Weighted Assets	15.2%	10.0%	5.2%
Tier 1 Capital to Risk Weighted Assets	14.0%	8.0%	6.0%
Tier 1 Capital to Average Assets	11.2%	5.0%	6.2%
Common Equity Tier 1 Capital to Risk Weighted Assets	13.1%	6.5%	6.6%

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 \$0.465 per share in 2015, an increase of \$0.015 over 2014. 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 2015 ranged from \$15.46 to \$17.90, and during 2014, from \$14.08 to \$16.04. 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, 2015, there were 4,015,233 shares of the Company's common stock outstanding held by approximately 215 holders of record.

Chesapeake Financial Shares, Inc. — Directors

Jeffrey M. Szyperski
Chairman of the Board,
Chief Executive Officer and President

Douglas D. Monroe, Jr.
Vice Chairman

Eugene S. Hudnall, Jr.
Owner and Operator
Kilmarnock Mini Storage

John H. Hunt II
EVP and Business Development
Chesapeake Investment Group

Thomas E. Kellum
Vice President
W. Ellery Kellum, Inc.

Craig J. Kelly
Managing Director
Creekside Consultants

Bruce P. Robertson
Retired CEO
Shirley Pewter Shops, Inc.

William F. Shumadine, Jr.
Former President
Central Fidelity Bank

Robert J. Singley, Sr.
President
RJS & Associates, Inc.

Thomas G. Tingle, AIA
President
Guernsey Tingle Architects

Chesapeake Bank — Directors

Jeffrey M. Szyperski
Chairman of the Board,
Chief Executive Officer and President

David E. Bush, CPA, CFP, PFS
Managing Director
PBMares Wealth Management, LLC

Charles C. Chase II
President, Chase Properties, Inc.

James M. Holmes, Jr.
CEO
Rappahannock General Hospital

Thomas E. Kellum
Vice President
W. Ellery Kellum, Inc.

Douglas D. Monroe, Jr.
Chairman Emeritus
Chesapeake Bank

Thomas G. Tingle, AIA
President
Guernsey Tingle Architects

Corporate Officers

Jeffrey M. Szyperski
Douglas D. Monroe, Jr.
Marshall N. Warner
John K. O'Shaughnessy
Dianne D. Hall
Rebecca A. Foster
John M. Sadler
Francis Bell III
Patricia R. Lewis
Paula A. Milsted
Donald J. Seeterlin
Tracy R. Pastella
Leigh H. Houghland
Jean H. Light
Trudy M. Quinto
Kevin S. Wood
Catherine J. Root
Richard L. Ware
Robert S. Cornwell
Elizabeth D. Swartz
Catherine D. Mise
Samuel G. Poole
Catherine W. Snowden
Thomas L. Adams
Beth P. Bartlett
Steven D. Callis
Robert G. Castleman
Melissa A. Crawford
Benjamin P. Ellington
Suzanne D. Keyser
Sarah A. Parsley
Thomas H. Richardson
Glenn F. Verity
Sherry T. Williams
Sherry M. Vanlandingham
Melissa G. Alexander
Michelle C. Brown
Anjillette S. Eamigh
Tucker K. Edmonds
Meredith W. Fernandez
Erin E. Hamlin
Tina K. Kent
Lisa M. McCullen
Donna M. Mitchell
Amy E. Mitchem
Johanna M. Northstein
Anita B. Pritchett
Diana N. Rock
Christopher M. Sikes
Kristie K. Smith
Sandra L. Smith
Teresa W. Stewart
Karen W. Story
Robert E. Wilbanks
Sherri L. Clowser
Ann Marie Pruitt

Chesapeake Investment Group, Inc. — Directors

John M. Sadler, President
Leland T. James
Craig J. Kelly
Douglas D. Monroe, Jr.
William F. Shumadine, Jr.
Jeffrey M. Szyperski
Marshall N. Warner

Chesapeake Trust Company, Inc. — Directors

Jean H. Light, President
Rebecca A. Foster
Ted M. Kattmann
John K. O'Shaughnessy
John M. Sadler
Jeffrey M. Szyperski
Marshall N. Warner

Chesapeake Financial Group, Inc. — Directors

Trudy M. Quinto, President
Rebecca A. Foster
John K. O'Shaughnessy
John M. Sadler
Jeffrey M. Szyperski
Marshall N. Warner

Chesapeake Investment Services — Directors

Trudy M. Quinto, President
Rebecca A. Foster
John K. O'Shaughnessy
John M. Sadler
Jeffrey M. Szyperski
Marshall N. Warner

Chesapeake Bank — Business Advisory Boards

Peninsula

David E. Bush, CPA, CFP, PFS
Vincent A. Campana
Catherine B. Chaplain
Richard A. Costello
Thomas G. Davis
J. Terry Deaver
Vernon M. Geddy III, Esq.
Timothy G. Harris
Stephen H. Montgomery
Bruce P. Robertson
Thomas G. Tingle, AIA

Northern Neck

Stuart A. Bunting
James N. Carter, Jr.
Sandra H. Hargett
S. Lynn Haynie
Susan F. Hill
Joseph P. Hudnall
William R. Lee
John S. Martin, Esq.
Susan C. McFadden
W. Bruce Sanders
Harold W. Warren

Middle Peninsula

Nancy H. Dykeman, CPA
J. Scott Finney
J. Ralph Jackson
Joseph K. Moorman
David W. Muffelman, M.D.
Charles B. Records
Martha W. Soles
Guy R. A. Sorensen
J. Stephen Wiseman



Chesapeake Financial Shares, Inc.

Chesapeake Bank

Chesapeake Investment Group

**Post Office Box 1419
Kilmarnock, Virginia 22482**

**804-435-1181
www.chesapeakefinancialshares.com**

Ticker Symbol CPKF