Carolina ALLIANCE BANK™

2013 Annual Report

CAROLINA ALLIANCE BANK AND SUBSIDIARY
2013 ANNUAL REPORT
Index

March 20, 2014

Dear Fellow Shareholders:

I am excited and proud to share this annual report which reflects our financial position at the end of our seventh year of operation. At Carolina Alliance, 2013 was an exciting year of change and investment for our future. Throughout 2013 and ongoing currently, our Board of Directors is implementing a growth strategy developed in late 2012 as economic conditions began to improve. As part of this agenda, our new Seneca office opened in January 2014, led by veteran bankers Kyle Thomas and Lori Comunal. Our Anderson office has received all required regulatory approvals, and we are working to bring that office "on line" early in the second quarter under the leadership of another veteran banker, Jack Buice.

The very exciting proposed merger with Forest Commercial Bank also is proceeding well as we strive for a second quarter closing. The merger application was approved by the FDIC on March 11, and our teams have been working hard behind the scenes on integration plans. As we noted in our earlier communications, we believe the benefits of this merger are numerous and will position us solidly for future growth and profitability.

Let me highlight some of our 2013 financial results:

The bank concluded 2013 with income before income taxes for the year of approximately $1,872,000, compared to $2,415,000 in the prior year, a decrease of 22%. Net income available to common shareholders for the year ended December 31, 2013 decreased by $470,000, or 31%, to $1,033,000 from $1,503,000 earned in the prior year. These decreases are primarily the result of merger-related costs and increased expenses associated with our branch expansions discussed above, which in the aggregate totaled approximately $492,000 on an after-tax basis.

Total assets were $247.4 million at December 31, 2013, which was down slightly from $249.6 million at December 31, 2012. At December 31, 2013, gross loans increased by 4.2% to $182.8 million over the $175.4 million gross loan total at December 31, 2012.

Total deposits contracted to $203.5 million at December 31, 2013 from $209.4 million at December 31, 2012. While deposits decreased overall, we saw an increase in the balances in checking and savings accounts, where the bank experienced an increase of 12% in 2013. Checking and savings accounts are a key part of core deposits, which tend to be a more stable funding source and are generally viewed as an indicator of a bank's success in establishing full banking relationships with its customers.

Total shareholders' equity was $32.0 million at December 31, 2013 compared to $31.8 million at December 31, 2012. We continued to maintain $5.0 million in preferred stock issued to the U.S. Treasury's Small Business Lending Fund (SBLF). The cost of this preferred stock became fixed at 1% during 2013.

Non-performing assets decreased since last year-end as a percentage of total assets. Non-performing assets improved to 0.72% of total assets at December 31, 2013 compared to 0.98% at December 31, 2012. A detailed analysis of our non-performing assets is included in the notes to the financial statements.

We are grateful for our amazing staff and Board and their outstanding efforts this past year, as well as for our loyal shareholders and customers, particularly for their support and patience over the last few economically challenging years. We are very excited about the coming additions of the Forest Commercial staff, directors, and shareholders to Carolina Alliance. Our plans for 2014 reflect our optimism for the economy and for implementation of our expansion plans. With our expanding footprint and the multiple benefits to be recognized in our merger with Forest Commercial, we believe our bank is well positioned to capitalize on the recovering economy and thrive in the future.

Thank you again for your continuing support of our growing bank.

Yours truly,

John S. Poole
President and CEO

elliott davis

Independent Auditor's Report

To the Board of Directors
Carolina Alliance Bank
Spartanburg, South Carolina

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Carolina Alliance Bank and Subsidiary which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Carolina Alliance Bank and Subsidiary as of December 31, 2013 and 2012, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Elliott Davis, LLC

Columbia, South Carolina
March 20, 2014

CAROLINA ALLIANCE BANK AND SUBSIDIARY

Consolidated Balance Sheets

December 31, 2013 and 2012

	2013	2012
Assets:		
Cash and due from banks	**$ 5,692,846**	$ 7,209,287
Federal funds sold and interest bearing bank balances	**855,115**	7,852,117
Total cash and cash equivalents	**6,547,961**	15,061,404
Bank term deposits	**6,723,000**	4,980,000
Investment securities, available for sale	**44,547,635**	46,902,315
Other investments	**389,000**	448,400
Loans, net	**179,330,714**	172,283,554
Property and equipment, net	**6,699,194**	6,864,968
Accrued interest	**705,547**	693,078
Other assets	**2,441,562**	2,409,399
Total assets	**$ 247,384,613**	$ 249,643,118
Liabilities and Shareholders' Equity:		
Liabilities:		
Deposits	**$ 203,499,827**	$ 209,353,951
Securities sold under agreements to repurchase	**10,142,253**	5,311,528
Advances from FHLB of Atlanta	**1,000,000**	2,000,000
Accrued interest	**44,428**	60,537
Other liabilities	**720,233**	1,158,366
Total liabilities	**215,406,741**	217,884,382
Commitments and contingencies (Notes 8, 9 and 17)		
Shareholders' Equity:		
Preferred stock, $1.00 par value, 10,000,000 shares authorized; 5,000 shares issued and outstanding at December 31, 2013 and 2012, respectively	**5,000**	5,000
Common stock, $1.00 par value, 10,000,000 shares authorized; 2,511,959 and 2,500,000 issued and outstanding at December 31, 2013 and 2012, respectively	**2,511,959**	2,500,000
Additional paid-in capital	**28,969,360**	28,775,231
Retained earnings (deficit)	**643,204**	(389,589)
Accumulated other comprehensive income (loss)	**(151,651)**	868,094
Total shareholders' equity	**31,977,872**	31,758,736
Total liabilities and shareholders' equity	**$ 247,384,613**	$ 249,643,118

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

CAROLINA ALLIANCE BANK AND SUBSIDIARY

Consolidated Statements of Income

For the Years Ended December 31, 2013 and 2012

	2013	2012
Interest Income:		
Interest and fees on loans	**$ 8,581,012**	$ 8,742,450
Investment securities	**983,687**	1,208,127
Federal funds sold and interest bearing bank deposits	**53,346**	54,367
Total interest income	**9,618,045**	10,004,944
Interest Expense:		
Deposits	**732,496**	1,088,842
Other	**88,442**	123,585
Total interest expense	**820,938**	1,212,427
Net Interest Income	**8,797,107**	8,792,517
Provision for Loan Losses	**475,000**	1,080,000
Net Interest Income After Provision for Loan Losses	**8,322,107**	7,712,517
Non-Interest Income:		
Service fees on deposit accounts	**238,247**	207,806
Mortgage brokerage income	**60,677**	154,523
Other	**185,071**	192,752
Gain on sale of securities available for sale	**6,619**	-
Loss on other real estate owned and repossessed assets	**(122,872)**	(164,360)
Total non-interest income	**367,742**	390,721
Non-Interest Expense:		
Salaries and benefits	**4,045,119**	3,547,375
Occupancy, furniture and equipment	**542,310**	518,606
Data processing and computer network	**581,750**	526,332
Marketing	**179,639**	157,299
Printing, supplies and postage	**90,165**	79,509
Merger-related expenses	**373,956**	-
Other operating	**1,004,715**	858,754
Total non-interest expense	**6,817,654**	5,687,875
Income Before Income Taxes	**1,872,195**	2,415,363
Income Tax Expense	**789,402**	862,482
Net Income	**1,082,793**	1,552,881
Dividends on Preferred Shares	**50,000**	50,000
Net Income Available to Common Shareholders	**$ 1,032,793**	$ 1,502,881
Basic and Diluted Income per Common Share	**$ 0.41**	$ 0.60
Weighted Average Common Shares Outstanding:		
Basic and Diluted	**2,509,042**	2,500,000

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

CAROLINA ALLIANCE BANK AND SUBSIDIARY

Consolidated Statements of Comprehensive Income

For the Years Ended December 31, 2013 and 2012

	2013		**2012**	
Net Income		**$ 1,082,793**		$ 1,552,881
Other Comprehensive Income (Loss):				
Unrealized gains (losses) on investment securities available for sale, pretax	**$ (1,644,898)**		$ 57,560	
Income tax effect	**629,065**	**(1,015,833)**	(32,411)	25,149
Reclassification of gain on sale of investment securities included in net income, pretax	**(6,619)**		-	
Income tax effect	**2,707**	**(3,912)**	-	-
Total other comprehensive income (loss)		**(1,019,745)**		25,149
Comprehensive Income		**$ 63,048**		$ 1,578,030

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

CAROLINA ALLIANCE BANK AND SUBSIDIARY

Consolidated Statements of Changes in Shareholders' Equity

For the Years Ended December 31, 2013 and 2012

	Preferred Stock		Common Stock				Accumulated Other Comprehensive	Total
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Retained (Deficit) Earnings	Income (Loss)	Shareholders' Equity
Balance, December 31, 2011	5,000	$ 5,000	2,500,000	$ 2,500,000	$28,593,859	$(1,892,470)	$ 842,945	$30,049,334
Stock-based compensation	-	-	-	-	181,372	-	-	181,372
Preferred stock dividends	-	-	-	-	-	(50,000)	-	(50,000)
Net income	-	-	-	-	-	1,552,881	-	1,552,881
Other comprehensive income	-	-	-	-	-	-	25,149	25,149
Balance, December 31, 2012	**5,000**	**5,000**	**2,500,000**	**2,500,000**	**28,775,231**	**(389,589)**	**868,094**	**31,758,736**
Stock-based compensation	**-**	**-**	**-**	**-**	**95,736**	**-**	**-**	**95,736**
Issuance of common shares	**-**	**-**	**11,959**	**11,959**	**98,393**	**-**	**-**	**110,352**
Preferred stock dividends	**-**	**-**	**-**	**-**	**-**	**(50,000)**	**-**	**(50,000)**
Net income	**-**	**-**	**-**	**-**	**-**	**1,082,793**	**-**	**1,082,793**
Other comprehensive loss	**-**	**-**	**-**	**-**	**-**	**-**	**(1,019,745)**	**(1,019,745)**
Balance, December 31, 2013	**5,000**	**$ 5,000**	**2,511,959**	**$ 2,511,959**	**$28,969,360**	**$ 643,204**	**$ (151,651)**	**$31,977,872**

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

CAROLINA ALLIANCE BANK AND SUBSIDIARY

Consolidated Statements of Cash Flows

For the Years Ended December 31, 2013 and 2012

	2013	2012
Operating Activities:		
Net income	**$ 1,082,793**	$ 1,552,881
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	**475,000**	1,080,000
Depreciation	**344,128**	354,076
Stock compensation	**95,736**	181,372
Deferred income tax expense	**14,430**	208,871
Amortization of premiums on investment securities, net	**361,593**	358,886
Gain on sale of investment securities available for sale	**(6,619)**	-
Net loss on other real estate owned	**122,872**	164,360
Decrease in other assets	**149,583**	138,444
Increase (decrease) in other liabilities	**177,531**	(595,012)
Net cash provided by operating activities	**2,817,047**	3,443,878
Investing Activities:		
Increase in loans, net	**(8,232,002)**	(9,524,281)
Purchase of investments:		
Investment securities available for sale	**(11,527,866)**	(9,301,186)
Bank term deposits	**(3,984,000)**	(2,490,000)
Other investments	**-**	(70,614)
Purchase of property and equipment	**(178,354)**	(166,663)
Proceeds from investment transactions:		
Principal payments on investment securities available for sale	**10,288,174**	11,128,238
Maturities and calls of investment securities available for sale	**-**	500,000
Sales of investment securities available for sale	**1,587,881**	251,573
Maturity of bank term deposits	**2,241,000**	1,245,000
Redemption of other investments	**59,400**	248,014
Proceeds from sale of other real estate owned	**378,324**	395,427
Net cash used for investing activities	**(9,367,443)**	(7,784,492)
Financing Activities:		
Net (decrease) increase in deposits	**(5,854,124)**	11,891,085
Issuance of common stock	**110,352**	-
Dividends paid on preferred stock	**(50,000)**	(50,000)
Repayment of borrowings from FHLB of Atlanta	**(1,000,000)**	(1,000,000)
Net increase (decrease) in securities sold under agreements to repurchase	**4,830,725**	(1,778,088)
Net cash (used for) provided by financing activities	**(1,963,047)**	9,062,997
Net (Decrease) Increase in Cash and Cash Equivalents	**(8,513,443)**	4,722,383
Cash and Cash Equivalents, Beginning of Period	**15,061,404**	10,339,021
Cash and Cash Equivalents, End of Period	**$ 6,547,961**	$ 15,061,404
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	**$ 837,047**	$ 1,254,519
Income taxes paid	**$ 751,679**	$ 834,500
Non-cash transactions:		
Loans transferred to other real estate owned	**$ 621,842**	$ 480,485
Loans transferred to repossessed collateral	**$ 88,000**	$ 102,427
Unrealized (losses) gains on investment securities	**$ (1,644,898)**	$ 57,560
Deferred income taxes on unrealized securities losses and gains	**$ 629,065**	$ (32,411)
Reclassification of gain on sale of investment securities included in net income	**$ (6,619)**	$ -
Deferred income taxes on securities gains reclassified	**$ 2,707**	$ -

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization - Carolina Alliance Bank (the "Bank") was incorporated and began operations in January 2007 and provides a broad array of commercial banking services to its customers. The Bank is subject to regulation of the South Carolina State Board of Financial Institutions and the Federal Deposit Insurance Corporation.

Basis of Presentation - The consolidated financial statements include the accounts of the Bank and its wholly-owned subsidiary, NSCB 2, LLC (whose only business activity is the holding of title to certain operating real estate). Significant intercompany balances and transactions have been eliminated. The accounting policies and reporting practices conform to accounting principles generally accepted in the United States of America ("GAAP") and to general practices in the banking industry.

Use of Estimates - The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amount of income and expenses during the reporting periods. Actual results could differ from those estimates.

Nature of Operations and Concentrations of Credit Risk - The Bank is engaged in the business of accepting demand and time deposits and providing loans to individuals and businesses. The Bank's business is limited primarily to Spartanburg and adjacent counties in the northwestern area of South Carolina. The Bank has a diversified loan portfolio and the borrowers' ability to repay their loans is not dependent upon any specific economic sector.

Disclosure Regarding Segments - The Bank reports as one operating segment, as the chief operating decision-maker reviews the results of operations of the Bank as a single enterprise.

Reclassifications - Certain amounts previously reported have been reclassified to conform to the current presentation of these consolidated financial statements. These reclassifications had no effect on previously reported net income or shareholders' equity.

Subsequent Events - Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through March 20, 2014, the date the financial statements were issued, and determined that no subsequent events have occurred requiring accrual or disclosure, except as disclosed in Note 17.

Cash and Cash Equivalents - For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, short-term interest bearing deposits and federal funds sold. Cash and cash equivalents have an original maturity of three months or less. Bank term deposits, consisting of FDIC-insured certificates of deposits with original maturities in excess of three months, are not included in cash and cash equivalents.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Securities - Investments in debt and equity securities are required to be classified into one of three categories: "trading," "held to maturity," or "available for sale." During the reporting periods, the Bank held no trading or held to maturity securities. Available for sale securities are debt and equity securities which are not classified as either trading or as held to maturity securities. These securities are reported at fair market value. Net unrealized gains and losses are reported as a separate component of shareholders' equity.

Gains or losses on dispositions of investment securities are determined on a trade date basis and are based on the difference between the net proceeds and the adjusted carrying amount of the securities sold, using the specific identification method. Premiums and discounts are amortized or accreted into interest income by a method that approximates a level yield.

The Bank periodically evaluates its investment securities portfolio for "other-than-temporary impairment." If a security is considered to be other-than-temporarily impaired, the related unrealized loss is charged to income, and a new cost basis is established. Factors considered include the reasons for the impairment; the severity and duration of the impairment; changes in value subsequent to period-end; and forecasted performance of the security issuer. Impairment is considered other-than-temporary unless the Bank has both the intent and ability to hold the security for a sufficient period of time to allow the fair market value to recover and evidence supporting the recovery outweighs evidence to the contrary.

Other Investments - Other investments consists of stock in the Federal Home Loan Bank of Atlanta ("FHLB") which the Bank is required to own as a member institution. Transfer of the stock is restricted, no ready market exists, and it has no quoted market value. However, redemption of the stock historically has been at par value; therefore it is stated at the Bank's cost basis.

Loans, Interest, and Fee Income on Loans - Loans are stated at the principal balance outstanding and reduced by the allowance for loan losses. Loan origination fees and certain direct loan origination costs are deferred and the net amount is accreted or amortized as an adjustment of the related loan's yield over the contractual life of the loan. Loan origination fees and costs are netted and the net amount either reduces or increases net loans outstanding. Interest income is recognized over the term of the loan based on the contractual interest rate and the principal balance outstanding.

Loans generally are placed on non-accrual status when principal or interest becomes 90 days past due, or when payment in full is not anticipated. Interest payments received after a loan is placed in non-accrual status are applied as principal reductions until such time as the loan is returned to accrual status. Generally, a loan is returned to accrual status when the loan is brought current and the collectability of principal and interest is no longer in doubt.

Allowance for Loan Losses - The Bank provides for loan losses using the allowance method. Provisions for loan losses are added to the allowance through charges to operating expenses. Loans which are determined to be uncollectible are charged against the allowance and recoveries on loans previously charged off are added to the allowance. The provision for loan losses charged to operations is an amount sufficient to bring the allowance for loan losses to an estimated balance considered adequate to absorb losses inherent in the portfolio.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management's determination of the adequacy of the allowance is based on an evaluation of the portfolio, current economic conditions, historical loan loss experience, and other risk factors. While management uses the best information available to make evaluations, future adjustments may be necessary if economic and other conditions differ substantially from the assumptions used. The allowance for loan losses is subject to periodic evaluation by various regulatory authorities and may be subject to adjustment upon their examination.

A loan is considered to be impaired when full payment according to the terms of the loan agreement is not probable or when the terms of a loan are modified in a troubled debt restructuring ("TDR"). The fair value of impaired loans may be determined based upon the present value of expected cash flows discounted at the loan's effective interest rate, the market price of the loan, if available, or, if the loan is collateral-dependent, the value of the underlying collateral, less estimated selling costs when foreclosure is imminent.

The treatment of the loan impairment is based on the status of the borrower and the underlying collateral. In general, the impairment is charged-off for collateral-dependent loans and consumer loans. For all other loans, a portion of the allowance for loan losses is allocated specifically to each impaired loan. When the ultimate collectability of an impaired loan's principal is in doubt, wholly or partially, all cash receipts are applied to principal. Once payments equal to the outstanding principal balance have been received, further cash receipts are applied to interest income, to the extent that any interest has been foregone.

Property and Equipment - Property and equipment are stated at cost, net of accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Building and fixtures have estimated useful lives of 10 to 40 years and furniture and equipment have estimated useful lives of 3 to 15 years. Maintenance and repairs are charged to operations, while major improvements are capitalized. Upon retirement, sale, or other disposition of property and equipment, the cost and accumulated depreciation are eliminated from the accounts and the gain or loss is included in income from operations.

Other Real Estate Owned and Repossessed Assets - Other real estate owned is comprised of real property acquired through a foreclosure proceeding or acceptance of a deed-in-lieu of foreclosure. Repossessed assets include personal property acquired through conveyance in satisfaction of debts. Other real estate owned and repossessed assets are recorded at the lower of the recorded investment in the loan at the time of acquisition or the fair value of the underlying property collateral, less estimated selling costs. Any write-down in the carrying value of a property at the time of acquisition is charged to the allowance for loan losses. Any subsequent write-downs to reflect current fair market value, as well as gains and losses on disposition and revenues and expenses incurred in maintaining such properties, are treated as period costs. Other real estate owned and repossessed assets are included in "Other assets" in the balance sheet and balances are summarized in Note 3.

Advertising - Advertising, promotional, and other business development costs generally are expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expensed in the period in which the direct mailings are sent.

Stock-Based Compensation - The Bank adopted a stock option plan on May 21, 2007. The fair value of the stock options issued under the plan is expensed over the vesting period of each option grant. Further information about the plan and the methodology to determine the fair value of stock options is detailed in Note 13.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes - The asset and liability approach is utilized to account for income taxes, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement carrying values and the tax bases of assets and liabilities, as well as net operating loss carry forwards. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. A current tax asset or liability is recognized for taxes that are presently payable and included in "Other assets" in the balance sheet.

The Bank has analyzed its filing positions in the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The Bank believes that income tax filing positions taken or expected to be taken in its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Bank's financial condition, results of operations, or cash flows. Therefore, no reserves for uncertain income tax positions have been recorded.

Earnings Per Share - Basic earnings per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income available to common shareholders by the weighted average number of common shares and potential common shares outstanding during the period. Potential common shares consist solely of dilutive stock options determined by the treasury stock method using the average market price of the shares during the period. The dilutive effect of stock options outstanding on earnings per share at December 31, 2013 and 2012 was either insignificant or non-existent.

Comprehensive Income - Comprehensive income consists of net income and net unrealized gains and losses on investment securities available for sale and is presented in the Consolidated Statements of Changes in Shareholders' Equity and in the separate Consolidated Statements of Comprehensive Income.

Fair Value Measurements - Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Fair values are determined under a hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs in the measurement process. There are three levels of inputs that may be used to measure fair value:

> *Level 1:* These inputs principally consist of quoted prices in active markets for identical assets or liabilities. (The Bank has no assets or liabilities measured by the use of Level 1 inputs.)
>
> *Level 2:* Observable inputs such as quoted prices for similar assets or liabilities or other inputs that are observable or can be corroborated by observable market data are the primary types of measurements that comprise Level 2.
>
> *Level 3:* Unobservable inputs that are supported by little or no market activity or that may involve using pricing models, discounted cash flow methodologies, or similar techniques are included in this level. The determination of values also may require significant management judgment or estimation.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recently Issued Accounting Standards - The Comprehensive Income topic of the Accounting Standards Codification ("ASC") was amended in June 2011. The amendment eliminated the option to present other comprehensive income as a part of the statement of changes in stockholders' equity and required consecutive presentation of the statement of net income and other comprehensive income. The amendments were applicable to the Bank January 1, 2012 and have been applied retrospectively.

In December 2011, the topic was further amended to defer the effective date of presenting reclassification adjustments from other comprehensive income to net income on the face of the financial statements while the Financial Accounting Standards Board ("FASB") redeliberated the presentation requirements for the reclassification adjustments. In February 2013, the FASB further amended the Comprehensive Income topic clarifying the conclusions from such redeliberations. Specifically, the amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments do require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, in certain circumstances an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The amendments were effective for the Bank on a prospective basis for reporting periods beginning after December 15, 2013, and its adoption did not have a material effect on the financial statements.

Other accounting standards that have been issued or proposed by standards-setting bodies are not expected to have a material impact on the Bank's financial position, results of operations or cash flows.

NOTE 2 - INVESTMENT SECURITIES

The amortized cost and fair value of investment securities available for sale at December 31, 2013 and 2012 are as follows:

	2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency and sponsored enterprises	$11,186,620	$ 6,111	$ (597,635)	$10,595,096
Agency mortgage-backed securities	18,267,967	398,711	(33,143)	18,633,535
Agency collateralized mortgage obligations	6,335,751	49,686	(99,815)	6,285,622
Municipal securities	9,013,883	72,550	(53,051)	9,033,382
Total available for sale	$44,804,221	$ 527,058	$ (783,644)	$44,547,635

NOTE 2 - INVESTMENT SECURITIES (continued)

	2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency and sponsored enterprises	$ 5,117,373	$ 111,958	$ -	$ 5,229,331
Agency mortgage-backed securities	25,911,046	1,037,875	(436)	26,948,485
Agency collateralized mortgage obligations	7,875,861	133,115	(3,755)	8,005,221
Municipal securities	6,603,104	142,825	(26,651)	6,719,278
Total available for sale	$45,507,384	$ 1,425,773	$ (30,842)	$46,902,315

In the year ended December 31, 2013, there were five sales of investment securities available for sale at a gain; there were no sales at a loss. The gross proceeds and gross gains realized are reflected in the Consolidated Statements of Cash Flows. In the year ended December 31, 2012, there was one sale of an investment security available for sale without gain or loss. The gross proceeds are reflected in the Consolidated Statements of Cash Flows.

For investment securities which had been in an unrealized loss position for less than 12 months, the number of securities, the fair value, and the gross unrealized losses for each investment security category at December 31, 2013 and 2012 are as follows.

	2013			2012		
	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses
U.S. government agency and sponsored enterprises	**23**	**$ 9,317,014**	**$ (533,470)**	-	$ -	$ -
Agency mortgage-backed securities	**10**	**4,896,276**	**(33,143)**	1	454,676	(436)
Agency collateralized mortgage obligations	**7**	**2,934,536**	**(55,633)**	3	1,633,330	(3,755)
Municipal securities	**6**	**1,737,203**	**(22,758)**	5	1,101,771	(26,651)
Total temporarily impaired securities	**46**	**$18,885,029**	**$ (645,004)**	9	$ 3,189,777	$ (30,842)

NOTE 2 - INVESTMENT SECURITIES (continued)

There were five investment securities which had been in an unrealized loss position for greater than 12 months at December 31, 2013 (no investment securities had been in an unrealized loss position for greater than 12 months at December 31, 2012). The number of securities, the fair value, and the gross unrealized losses for each investment security category at December 31, 2013 and 2012 are as follows.

	2013			2012		
	#	Fair Value	Unrealized Losses	#	Fair Value	Unrealized Losses
U.S. government agency and sponsored enterprises	1	$ 652,943	$ (64,165)	-	$ -	$ -
Agency mortgage-backed securities	-	-	-	-	-	-
Agency collateralized mortgage obligations	2	871,195	(44,182)	-	-	-
Municipal securities	2	503,358	(30,293)	-	-	-
Total temporarily impaired securities	5	$ 2,027,496	$ (138,640)	-	$ -	$ -

Based on its other-than-temporary impairment analysis at December 31, 2013, management concluded that the unrealized losses reflected in the preceding summaries were not other-than-temporarily impaired as of that date. Management believes the decline in value to be solely the result of changes in interest rates and not from deterioration in the securities' quality. The Bank has the intention and ability to hold these securities for a period of time sufficient to allow for their recovery in value or maturity.

Investment securities at December 31, 2013 and 2012 were pledged as collateral for the following purposes (at fair value):

	2013	2012
FHLB advances	$ 2,017,327	$ 3,021,331
Customer repurchase agreements	10,688,146	5,318,350
Public entity deposits	8,383,825	8,504,306
Total	$ 21,089,298	$ 16,843,987

Amortized cost and fair value of securities available for sale at December 31, 2013, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities and collateralized mortgage obligations are shown separately since they are not due at a single maturity date.

	Amortized Cost	Fair Value
Due within one year or less	$ 1,319,008	$ 1,313,660
Due after one through five years	7,533,518	7,593,541
Due after five through ten years	10,972,668	10,344,720
Due after ten years	375,309	376,557
No contractual maturity	24,603,718	24,919,157
Total investment securities	$ 44,804,221	$ 44,547,635

NOTE 3 - LOANS

Loans receivable at December 31, 2013 and 2012 consisted of the following:

	2013	2012
Commercial	**$ 35,646,157**	$ 36,708,887
Real estate:		
Commercial	**115,018,431**	103,137,037
Residential	**26,464,575**	27,720,951
Construction	**1,742,417**	4,147,066
Consumer	**3,857,454**	3,544,694
Gross loans	**182,729,034**	175,258,635
Allowance for loan losses	**(3,515,034)**	(3,082,443)
Deferred loan fees and costs, net	**116,714**	107,362
Net loans	**$ 179,330,714**	$ 172,283,554

At December 31, 2013, substantially all of the Bank's residential mortgage loans were pledged as collateral for advances from the FHLB under the borrowing facility described in Note 6.

A summary of changes in the allowance for loan losses is as follows for the years ended December 31, 2013 and 2012:

	2013	2012
Balance, beginning of period	**$ 3,082,443**	$ 3,772,606
Provision for loan losses	**475,000**	1,080,000
Loans charged off	**(205,558)**	(1,875,799)
Recoveries	**163,149**	105,636
Balance, end of period	**$ 3,515,034**	$ 3,082,443

The Bank makes loans to individuals and small- to mid-sized businesses for various personal and commercial purposes primarily in the upstate region of South Carolina. Credit concentrations can exist in relation to individual or groups of borrowers, industry segments, geographic regions and collateral characteristics. Credit risk associated with these concentrations could arise when a significant amount of loans sharing similar characteristics are simultaneously impacted by economic or other conditions which adversely affect their collectability. The Bank regularly monitors its credit concentrations. The Bank's loan portfolio is not concentrated in loans to any single borrower or a relatively small number of borrowers. The largest component of the loan portfolio is loans secured by real estate mortgages which were comprised of the following at December 31, 2013 (construction loans have been allocated to commercial and residential categories as appropriate):

NOTE 3 - LOANS (continued)

	Amount	% of Real Estate Loans
Commercial real estate :		
Owner-occupied	**$ 60,537,865**	**42.3%**
Other	**55,460,633**	**38.7%**
Total commercial real estate	**115,998,498**	**81.0%**
Residential real estate	**27,226,925**	**19.0%**
Total real estate loans	**$ 143,225,423**	**100.0%**
% of gross loans	**78.4%**	

In addition to monitoring potential concentrations described above, management monitors exposure to credit risk that could arise from potential concentrations of lending products and practices, such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc.) and loans with high loan-to-value ratios. At December 31, 2013, approximately $7.0 million, or 3.8% of gross loans, were identified as having high loan-to-value ratios. The largest component comprising these loans was commercial real estate loans of approximately $4.0 million which was below the aggregate supervisory loan-to-value limit of 30% of capital for this type of loan by approximately $5.5 million.

The remainder of the balance of high loan-to-value loans, $3.0 million, was also well below supervisory limits. Additionally, there are industry practices that could subject the Bank to increased credit risk should economic conditions change over the course of a loan's life. For example, the Bank makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e. balloon payment loans). These loans are underwritten and monitored to manage the associated risks. Management has determined that there is no concentration of credit risk associated with its lending policies or practices.

NOTE 3 - LOANS (continued)

Credit quality of individual residential loans and consumer loans is monitored principally through review of delinquency measures and non-accrual levels on a portfolio-level basis. The Bank uses an internal loan grading system to classify and monitor the credit quality of all commercial loans. Loan risk grades are based on a graduated scale representing increasing likelihood of loss. The originating loan officers are responsible for the assignment of risk grades to commercial loans, subject to verification by an approving officer or the Management Loan Committee. In addition, the Credit Policy Officer is responsible for confirming loan grades and, along with the Management Loan Committee, has final authority over loan grading. Loan gradings also are reviewed on a regular basis by an independent third-party loan review firm. Individual loan officers also are responsible for ensuring that loan grades are updated as needed over the life of the loan. Loan grade descriptions and a summary of the grading of the Bank's loan portfolio by segment at December 31, 2013 and 2012 are as follows:

Grade 1 - High Liquidity; Minimal Risk - Grade is based on highest quality liquid collateral, minimum risk, and excellent ratios.

Grade 2 - Strong Liquidity; Low Risk - Borrower has strong financial statements, or loan is secured by marketable securities without impairment to liquidation. Although one measure removed from Grade 1, any unfavorable factor is outweighed by other positive considerations.

Grade 3 - Normal Liquidity; Average Risk - Reasonable and satisfactory risk exists in these loans to borrowers with good financial strength. The loan's purpose becomes a more significant factor at this level.

Grade 4 - Pass/Watch; Marginal Liquidity; Average Risk - Includes borrowers with generally acceptable credit strength, but with manageable weaknesses or uncertainty evident in one or more factors.

Grade 5 - Special Mention/Potential Problem; Uncertain Liquidity; More than Normal Risk - Loans with potential weaknesses that deserve management's close attention are included. If left uncorrected, these potential weaknesses may result in deterioration of repayment prospects.

Grade 6 - Substandard/Problem Loan; Minimal Liquidity; Abnormal Risk (Unacceptable) - The Bank is inadequately protected by the current sound worth and paying capacity of the borrower or of any pledged collateral. Well-defined weakness or weaknesses that jeopardize the liquidation of the debt is present. The loan is characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Grade 7 - Doubtful; Loss Potential; Absence of Liquidity - These loans exhibit all the weaknesses inherent in Grade 6 with the added characteristic that the weaknesses make collection in full highly questionable and improbable.

NOTE 3 - LOANS (continued)

Grade 8 - Loss/Charge-Off - Considered uncollectible; some recovery potential may exist, but the probability of such recovery does not support continued reflection of the loan as an asset.

Not Graded - Primarily consists of individual residential or consumer loans not assigned a risk grade, in accordance with the Bank's credit policy. Also not graded may be commercial loans for which a grade is pending because the loan is under review.

The composition of the loan portfolio by segment and grade at December 31, 2013 is as follows:

		Real Estate				
	Commercial	**Commercial**	**Residential**	**Construction**	**Consumer**	**Total**
Grade 1	**$ 813,020**	**$ -**	**$ -**	**$ -**	**$ -**	**$ 813,020**
Grade 2	**1,779,549**	**-**	**-**	**-**	**-**	**1,779,549**
Grade 3	**10,223,584**	**37,180,323**	**-**	**322,865**	**-**	**47,726,772**
Grade 4	**21,766,550**	**69,265,065**	**693,758**	**-**	**-**	**91,725,373**
Grade 5	**524,979**	**3,690,023**	**253,600**	**-**	**1,000**	**4,469,602**
Grade 6	**27,080**	**4,882,570**	**322,414**	**550,953**	**10,941**	**5,793,958**
Grades 7, 8	**-**	**-**	**-**	**-**	**-**	**-**
Not graded	**511,395**	**450**	**25,194,803**	**868,599**	**3,845,513**	**30,420,760**
Gross loans	**$35,646,157**	**$115,018,431**	**$26,464,575**	**$ 1,742,417**	**$ 3,857,454**	**$182,729,034**

The composition of the loan portfolio by segment and grade at December 31, 2012 is as follows:

		Real Estate				
	Commercial	**Commercial**	**Residential**	**Construction**	**Consumer**	**Total**
Grade 1	$ 2,125,447	$ -	$ -	$ -	$ -	$ 2,125,447
Grade 2	1,955,111	-	-	-	-	1,955,111
Grade 3	10,454,356	37,383,168	-	470,774	476	48,308,774
Grade 4	20,461,618	57,072,143	276,299	3,065,966	-	80,876,026
Grade 5	1,147,438	1,486,502	368,965	-	3,615	3,006,520
Grade 6	307,036	5,805,399	572,591	577,526	19,050	7,281,602
Grades 7, 8	100,000	-	-	-	11,005	111,005
Not graded	157,881	1,389,825	26,503,096	32,800	3,510,548	31,594,150
Gross loans	$36,708,887	$103,137,037	$27,720,951	$ 4,147,066	$ 3,544,694	$175,258,635

NOTE 3 - LOANS (continued)

The composition of non-performing assets at December 31, 2013 and 2012 is as follows:

	2013	2012
Non-accrual loans:		
Commercial	**$ 4,697**	$ 290,845
Real estate:		
Commercial	**665,377**	880,467
Residential	**-**	353,942
Construction	**-**	-
Consumer	**-**	11,005
Total non-accrual loans	**670,074**	1,536,259
Other real estate owned	**1,108,731**	797,658
Repossessed collateral	**-**	102,427
Non-performing assets	**$ 1,778,805**	$ 2,436,344
Loans past due 90 days or more still accruing interest	**$ -**	$ -

The composition of past due loans by portfolio segment at December 31, 2013 is as follows:

	30-59 Days	60-89 Days	Greater than 90 Days	Total Past Due	Current	Total Loans
Commercial	**$ -**	**$ 11,331**	**$ 4,697**	**$ 16,028**	**$ 35,630,129**	**$ 35,646,157**
Real estate:						
Commercial	**497,044**	**453,126**	**665,377**	**1,615,547**	**113,402,884**	**115,018,431**
Residential	**107,336**	**-**	**-**	**107,336**	**26,357,239**	**26,464,575**
Construction	**-**	**-**	**-**	**-**	**1,742,417**	**1,742,417**
Consumer	**-**	**-**	**-**	**-**	**3,857,454**	**3,857,454**
Gross loans	**$ 604,380**	**$ 464,457**	**$ 670,074**	**$ 1,738,911**	**$180,990,123**	**$182,729,034**

The composition of past due loans by portfolio segment at December 31, 2012 is as follows:

	30-59 Days	60-89 Days	Greater than 90 Days	Total Past Due	Current	Total Loans
Commercial	$ -	$ -	$ 290,845	$ 290,845	$ 36,418,042	$ 36,708,887
Real estate:						
Commercial	1,064,800	4,576	880,467	1,949,843	101,187,194	103,137,037
Residential	-	-	353,942	353,942	27,367,009	27,720,951
Construction	-	-	-	-	4,147,066	4,147,066
Consumer	4,415	-	11,005	15,420	3,529,274	3,544,694
Gross loans	$1,069,215	$ 4,576	$ 1,536,259	$ 2,610,050	$172,648,585	$175,258,635

NOTE 3 - LOANS (continued)

The following tables summarize information relative to impaired loans by portfolio segment.

	December 31, 2013				
	Recorded Investment	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**
With no related allowance:					
Commercial	**$ 312**	**$ 4,325**	**$ -**	**$ 40,202**	**$ 4,013**
Real estate:					
Commercial	**2,424,135**	**2,444,877**	**-**	**2,492,134**	**135,059**
Residential	**376,409**	**376,409**	**-**	**387,278**	**9,585**
Construction	**-**	**-**	**-**	**-**	**-**
Consumer	**10,822**	**10,822**	**-**	**11,809**	**1,063**
	2,811,678	**2,836,433**	**-**	**2,931,423**	**149,720**
With a related allowance:					
Commercial	**-**	**-**	**-**	-	**-**
Real estate:					
Commercial	**2,771,657**	**2,771,657**	**554,000**	**2,779,329**	**115,629**
Residential	**-**	**-**	**-**	**-**	**-**
Construction	**550,953**	**550,953**	**189,000**	**563,293**	**28,556**
Consumer	**-**	**-**	**-**	**-**	**-**
	3,322,610	**3,322,610**	**743,000**	**3,342,622**	**144,185**
Total impaired loans:					
Commercial	**312**	**4,325**	**-**	**40,202**	**4,013**
Real estate:					
Commercial	**5,195,792**	**5,216,534**	**554,000**	**5,271,463**	**250,688**
Residential	**376,409**	**376,409**	**-**	**387,278**	**9,585**
Construction	**550,953**	**550,953**	**189,000**	**563,293**	**28,556**
Consumer	**10,822**	**10,822**	**-**	**11,809**	**1,063**
	$ 6,134,288	**$ 6,159,043**	**$ 743,000**	**$ 6,274,045**	**$ 293,905**
Troubled debt restructurings included in impaired loans:					
Accruing	**$ 5,015,473**	**$ 5,015,473**	**$ 743,000**	**$ 5,067,627**	**$ 236,460**
Non-accrual	**329,141**	**349,816**	**-**	**383,539**	**16,392**
	$ 5,344,614	**$ 5,365,289**	**$ 743,000**	**$ 5,451,166**	**$ 252,852**

NOTE 3 - LOANS (continued)

	December 31, 2012				
	Recorded Investment	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**
With no related allowance:					
Commercial	$ 290,845	$ 941,103	$ -	$ 1,128,633	$ 26,424
Real estate:					
Commercial	1,803,980	2,282,205	-	1,920,896	65,103
Residential	752,401	998,401	-	900,162	20,339
Construction	-	-	-	-	-
Consumer	11,005	11,005	-	11,008	644
	2,858,231	4,232,714	-	3,960,699	112,510
With a related allowance:					
Commercial	-	-	-	-	-
Real estate					
Commercial	2,787,241	2,787,241	554,000	2,792,034	120,049
Residential	-	-	-	-	-
Construction	577,526	577,526	189,000	582,290	33,280
Consumer	-	-	-	-	-
	3,364,767	3,364,767	743,000	3,374,324	153,329
Total impaired loans:					
Commercial	290,845	941,103	-	1,128,633	26,424
Real estate:					
Commercial	4,591,221	5,069,446	554,000	4,712,930	185,152
Residential	752,401	998,401	-	900,162	20,339
Construction	577,526	577,526	189,000	582,290	33,280
Consumer	11,005	11,005	-	11,008	644
	$ 6,222,998	$ 7,597,481	$ 743,000	$ 7,335,023	$ 265,839
Troubled debt restructurings included in impaired loans:					
Accruing	$ 4,686,740	$ 4,686,740	$ 743,000	$ 4,713,801	$ 231,788
Non-accrual	805,299	1,905,558	-	1,439,639	14,598
	$ 5,492,039	$ 6,592,298	$ 743,000	$ 6,153,440	$ 246,386

NOTE 3 - LOANS (continued)

At December 31, 2013, the outstanding recorded investment in loans which had been determined in prior years to be impaired under ASC 310-10-35 was $4,836,205, and there was $743,000 in related allowance for loan losses associated with those loans. Following is a summary of loans determined to be TDRs during the years ended December 31, 2013 and 2012:

	2013			2012		
	Number of Loans	Amount Pre-Modification	Amount Post-Modification	Number of Loans	Amount Pre-Modification	Amount Post-Modification
Commercial	**-**	**$ -**	**$ -**	1	$ 246,679	$ 246,679
Real estate:						
Commercial	**5**	**404,096**	**404,096**	1	57,933	57,933
Residential	**1**	**93,491**	**93,491**	1	218,649	218,649
Construction	**-**	**-**	**-**	-	-	-
Consumer	**1**	**10,822**	**10,822**	1	11,005	11,005
	7	**$ 508,409**	**$ 508,409**	4	$ 534,266	$ 534,266

Of the loans that were identified as TDRs during the year ended December 31, 2013, all seven involved financial difficulty with renewal terms that did not mitigate the increased potential risk. During the year ended December 31, 2013, one loan that had been previously restructured defaulted. The recorded investment at the loan's default was $100,000. During the year ended December 31, 2012, no loans that had been previously restructured had payment defaults. During the year ended December 31, 2013, there were two loans that had been previously restructured removed from this classification. One was paid off by the borrower, and the second was charged off due to a consistently poor payment pattern. The recorded investment at the loan's charge-off was approximately $8,000. During the year ended December 31, 2012, there were no loans that had been previously restructured removed from this classification (except by pay-offs).

The following tables summarize activity related to the allowance for loan losses by portfolio segment for the year ended December 31, 2013:

	Balance Beginning of Year	Provision for Loan Losses	Loan Charge Offs	Loan Recoveries	Balance End of Period
Commercial	**$ 442,399**	**$ 13,273**	**$ (11,812)**	**$ 25,227**	**$ 469,087**
Real estate:					
Commercial	**1,214,502**	**494,263**	**(130,000)**	**126,189**	**1,704,954**
Residential	**370,126**	**(11,235)**	**(29,542)**	**8,660**	**338,009**
Construction	**896,129**	**(38,873)**	**-**	**-**	**857,256**
Consumer	**159,287**	**17,572**	**(34,204)**	**3,073**	**145,728**
Total	**$3,082,443**	**$ 475,000**	**$ (205,558)**	**$ 163,149**	**$3,515,034**

NOTE 3 - LOANS (continued)

The following table summarizes activity related to the allowance for loan losses for the year ended December 31, 2012 by portfolio segment:

	Balance Beginning of Year	Provision for Loan Losses	Loan Charge Offs	Loan Recoveries	Balance End of Year
Commercial	$ 606,908	$ 774,882	$ (950,350)	$ 10,959	$ 442,399
Real estate:					
Commercial	2,305,371	(812,443)	(369,229)	90,803	1,214,502
Residential	378,658	514,246	(525,348)	2,570	370,126
Construction	316,437	579,692	-	-	896,129
Consumer	165,232	23,623	(30,872)	1,304	159,287
Total	$3,772,606	$1,080,000	$(1,875,799)	$ 105,636	$3,082,443

The following table presents the basis upon which loans in each portfolio segment were reviewed for impairment, with the related allowance for loan losses broken out on the same basis, at December 31, 2013 and 2012:

	2013					
	Gross Loans			**Allowance for Loan Losses**		
	Basis of Review		**Segment**	**Basis of Review**		**Segment**
	Individual	**Collective**	**Total**	**Individual**	**Collective**	**Total**
Commercial	**$ 312**	**$ 35,645,845**	**$ 35,646,157**	**$ -**	**$ 469,087**	**$ 469,087**
Real estate:						
Commercial	**5,195,792**	**109,822,639**	**115,018,431**	**554,000**	**1,150,954**	**1,704,954**
Residential	**376,409**	**26,088,166**	**26,464,575**	**-**	**338,009**	**338,009**
Construction	**550,953**	**1,191,464**	**1,742,417**	**189,000**	**668,256**	**857,256**
Consumer	**10,822**	**3,846,632**	**3,857,454**	**-**	**145,728**	**145,728**
Total	**$6,134,288**	**$176,594,746**	**$182,729,034**	**$ 743,000**	**$ 2,772,034**	**$3,515,034**

	2012					
	Gross Loans			**Allowance for Loan Losses**		
	Basis of Review		**Segment**	**Basis of Review**		**Segment**
	Individual	**Collective**	**Total**	**Individual**	**Collective**	**Total**
Commercial	$ 290,845	$ 36,418,042	$ 36,708,887	$ -	$ 442,399	$ 442,399
Real estate:						
Commercial	4,591,221	98,545,816	103,137,037	554,000	660,502	1,214,502
Residential	752,401	26,968,550	27,720,951	-	370,126	370,126
Construction	577,526	3,569,540	4,147,066	189,000	707,129	896,129
Consumer	11,005	3,533,689	3,544,694	-	159,287	159,287
Total	$6,222,998	$169,035,637	$175,258,635	$ 743,000	$ 2,339,443	$3,082,443

NOTE 4 - PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2013 and 2012 are summarized as follows:

	2013	2012
Land	**$ 1,115,352**	$ 1,115,352
Building	**5,356,495**	5,356,495
Furniture and equipment	**2,199,775**	2,083,915
	8,671,622	8,555,762
Less accumulated depreciation	**1,972,428**	1,690,794
Property and equipment, net	**$ 6,699,194**	$ 6,864,968

Depreciation expense for the years ended December 31, 2013 and 2012 was $344,128 and $354,076, respectively. During the year ended December 31, 2013, fully depreciated computer equipment with total original book value of $62,494 was retired.

NOTE 5 - DEPOSITS

Deposit accounts at December 31, 2013 and 2012 are summarized as follows:

	2013	2012
Non-interest bearing deposits	**$ 28,602,201**	$ 24,319,214
Interest bearing deposits:		
Interest checking	**18,944,242**	19,643,381
Money market	**95,201,054**	100,346,898
Savings	**3,794,519**	1,865,151
Time, less than $100,000	**14,956,636**	17,085,356
Time, $100,000 and over	**42,001,175**	46,093,951
Total deposits	**$ 203,499,827**	$ 209,353,951

At December 31, 2013 and 2012 there were deposits amounting to approximately $4.2 million and $6.0 million, respectively, obtained from outside the Bank's market area through the internet and deposit brokers.

At December 31, 2013 the scheduled maturities of time deposits were as follows:

2014	**$ 47,828,003**
2015	**4,332,221**
2016	**4,571,587**
2017	**226,000**
Total time deposits	**$ 56,957,811**

NOTE 6 - OTHER BORROWINGS

Repurchase Agreements - All of the Bank's repurchase agreements are with its commercial deposit customers. At December 31, 2013 and 2012, respectively, balances of $10,142,253 and $5,311,528 were outstanding at rates of 0.30% and 0.35% for the respective period ends.

Federal Funds Lines of Credit - The Bank maintains federal funds lines of credit with correspondent banks to meet short-term liquidity needs. Advances under these agreements are unsecured and are limited to terms ranging from seven to 15 days. These banks have reserved the right to withdraw these lines at their option. At December 31, 2013, the Bank had credit availability of $17.4 million under these lines with no advances outstanding.

FHLB Line of Credit - The Bank has an approved credit line with the FHLB of approximately $24.7 million, subject to the Bank's ability to pledge qualifying collateral. Advances totaled $1.0 million and $2.0 million at December 31, 2013 and 2012, respectively.

The advance is at a fixed rate with interest paid monthly and principal paid at maturity. The following table summarizes the FHLB borrowing at December 31, 2013:

Maturity Date	Balance	Interest Rate
September 29, 2014	**$ 1,000,000**	**3.03 %**

Federal Reserve Bank Credit Facility - The Bank is eligible to borrow through the Federal Reserve Bank's ("FRB") "Discount Window" program. Any borrowings under this program must be secured by eligible collateral and are limited to very short terms, typically overnight. The FRB has indicated that though institutions are not required to seek funding elsewhere before requesting credit, they expect that institutions will use the Discount Window as a backup rather than a regular source of funding. The Bank has never used this funding source, but maintains it as a part of its contingency funding plan. The Bank estimates that credit availability under this program was approximately $103.8 million at December 31, 2013.

NOTE 7 - INCOME TAXES

The income tax effects of temporary differences between financial statement carrying values and the tax bases of assets and liabilities, as well as net operating loss carryforwards at December 31, 2013 and 2012 are as follows:

	2013	2012
Deferred tax assets:		
Allowance for loan losses	**$ 948,952**	$ 793,774
Organization and start-up costs	**126,094**	141,856
Other real estate owned	**245,716**	169,746
Non-qualified stock options	**169,158**	143,774
Unrealized losses on securities available for sale	**104,935**	-
Other	**86,107**	175,820
Total deferred tax assets	**1,680,962**	1,424,970
Deferred tax liabilities:		
Property and equipment	**388,661**	366,451
Loan origination costs	**85,389**	77,930
Unrealized gains on securities available for sale	**-**	526,837
Other	**163,447**	27,629
Total deferred tax liabilities	**637,497**	998,847
Net deferred tax asset	**$ 1,043,465**	$ 426,123

Deferred tax assets represent the future tax benefit of deductible differences and, if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the recorded deferred tax assets to net realizable value. At December 31, 2013 and 2012, management determined that no valuation allowance was necessary.

The Bank has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions.

The Bank's federal and state income tax returns are open and subject to examination from the 2010 tax return year and forward.

The income tax expense (benefit) for the years ended December 31, 2013 and 2012 is summarized as follows:

	2013	2012
Income taxes currently payable	**$ 774,972**	$ 653,611
Net deferred income tax expense	**14,430**	208,871
Income tax expense	**$ 789,402**	$ 862,482

NOTE 7 - INCOME TAXES (continued)

The income tax expense for the years ended December 31, 2013 and 2012 is reconciled to the amount of income tax computed at the federal statutory rate of 34% on income before income taxes as follows:

	2013	2012
Tax expense at statutory rate	**$ 636,546**	$ 821,223
Increase (decrease) in taxes resulting from:		
Non-deductible merger costs	**105,956**	-
Stock option compensation	**7,166**	31,068
State income taxes, net of federal benefit	**16,080**	23,060
Tax- exempt interest income	**(31,911)**	(24,263)
Other, net	**55,565**	(11,394)
Income tax expense	**$ 789,402**	$ 862,482

NOTE 8 - COMMITMENTS AND CONTINGENCIES

During the years ended December 31, 2013 and 2012, the Bank leased several office facilities and various equipment under operating leases. Lease expense for the years ended December 31, 2013 and 2012 was approximately $17,000 and $6,000, respectively. Future minimum rental payments under non-cancelable operating leases having remaining terms in excess of one year in the aggregate are not material.

The Bank has a contract for data processing services with a remaining term of 42 months at December 31, 2013 with an average monthly minimum payment of approximately $30,000.

The Bank has entered into employment agreements with two executive officers. The initial three-year terms expired December 15, 2011, and the agreements were and will continue to be extended automatically for successive one-year terms unless a respective officer’s employment is terminated under various provisions of the agreements. These agreements include provisions regarding term, compensation, benefits, incentive programs, stock option plans, severance, and non-compete provisions.

Management is not aware of any legal proceedings which would have a material adverse effect on the financial position or operating results of the Bank.

NOTE 9 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK

In the ordinary course of business, and to meet the financing needs of its customers, the Bank is a party to various financial instruments with off-balance sheet risk. These financial instruments, which include commitments to extend credit and standby letters of credit, involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheet. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank’s exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amounts of those instruments. The same credit policies used for on-balance sheet instruments are used in making commitments and conditional obligations.

NOTE 9 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK (continued)

The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, and commercial and residential real estate. Since many of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any material condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. At December 31, 2013, the Bank's commitments to extend additional credit totaled approximately $34.2 million, the majority of which are at variable rates of interest with varying maturities. Included in the Bank's total commitments are standby letters of credit. Letters of credit are commitments issued by the Bank to guarantee the performance of a customer to a third party and totaled approximately $239,000 at December 31, 2013.

NOTE 10 - EMPLOYEE BENEFIT PLAN

The Bank has a 401(k) plan which covers all eligible employees. Participants may contribute up to $17,500 per year, and the Bank matches contributions equal to 100% of employee contributions up to three percent (3%) of eligible compensation plus 50% of employee contributions up to the next two percent (2%) of eligible compensation. Contributions to the plan were approximately $111,000 and $99,000 in the years ended December 31, 2013 and 2012, respectively.

NOTE 11 - PREFERRED STOCK

On August 23, 2011, the Bank completed the sale of $5 million of Series A preferred stock to the Secretary of the Treasury under the Small Business Lending Fund ("SBLF"). The fund was established under the Small Business Jobs Act of 2010 that was created to encourage lending to small businesses by providing capital to qualified community banks with assets less than $10 billion.

Under the terms of the stock purchase agreement, the Treasury received 5,000 shares of $1.00 par value, non-cumulative perpetual preferred stock with a liquidation value of $1,000 per share in exchange for $5 million.

The Series A preferred stock qualifies as Tier 1 capital. Beginning with the initial dividend period, which ended September 30, 2011, and for each dividend period since, the Bank's dividend rate was one percent (1%). As of December 31, 2013, under the terms of the related purchase agreement, the dividend rate became fixed at one percent (1%). The Bank paid dividends of $50,000 for both years ended December 31, 2013 and 2012.

Subject to regulatory approval, the Bank is generally permitted to redeem the Series A preferred shares at par plus unpaid dividends.

NOTE 12 - DIVIDENDS

Currently, the Bank has no plans to initiate payment of cash dividends on its common shares. It is anticipated that any future dividends paid by the Bank to common shareholders would be dependent on earnings, capital requirements, and financial condition. Additionally, as a condition of receiving a state banking charter, the Bank agreed to pay no cash dividends until its retained deficit was eliminated, which took place during the second quarter of 2013. This restriction was waived in connection with the Bank's participation in the SBLF program with regard to dividends on the Series A preferred stock.

NOTE 13 - STOCK COMPENSATION

Stock Option Plan - The Bank has a stock option plan for the benefit of the Bank's officers, employees, and directors. Under terms of the Plan, the Board may grant options to purchase common stock ("options") of the Bank aggregating up to 525,000 shares. Options issued under the plan have an exercise price equal to the stock's fair market value (based on the most recent over-the-counter stock trades) on the grant date. The life of options granted cannot exceed 10 years. On February 16, 2010, the Plan was amended to allow members of the Board to participate in the Plan.

The following is a summary of activity in the stock option plan for the years ended December 31, 2013 and 2012:

	2013			**2012**		
	Shares	**Weighted Average Exercise Price**	**Weighted Average Fair Value**	**Shares**	**Weighted Average Exercise Price**	**Weighted Average Fair Value**
Outstanding, beginning of year	**394,000**	**$ 10.16**	**$ 4.07**	394,000	$ 10.19	$ 4.07
Granted	**26,000**	**9.38**	**3.41**	-	-	-
Forfeited	**-**	**-**	**-**	-	-	-
Outstanding, end of period	**420,000**	**10.14**	**4.03**	394,000	10.19	4.07
Options exercisable	**333,600**	**10.30**	**4.10**	309,700	10.34	4.11
Non-vested options, end of period	**86,400**	**9.55**	**3.75**	84,300	9.64	3.90
Options vesting during period	**23,900**	**9.69**	**3.91**	69,900	10.37	4.07
Shares available for grant	**105,000**			131,000		

All options outstanding have a 10-year life and substantially all have a five-year vesting period. Stock options outstanding and vested at December 31, 2013 have an average remaining life of 4.6 years. Exercise prices per share of outstanding stock options range from $9.50 to $16.50. At December 31, 2013, 309,600 options had an intrinsic value of approximately $100,000. At December 31, 2012, 28,000 options had an insignificant amount of intrinsic value.

NOTE 13 - STOCK COMPENSATION (continued)

The Bank utilizes the Black-Scholes valuation model to determine the compensation recognized under the fair value method described in Note 1. This fair value is then amortized on a straight-line basis over the vesting period of the option.

The following assumptions were utilized in the application of the Black-Scholes model for the year ended December 31, 2013 (no options were issued in the year ended December 31, 2012):

Weighted average risk-free interest rate - The risk-free interest rate used to value option grants is based on the U.S. Treasury yield curve on the date of grant.

Expected volatility - As the Bank has a relatively short trading history, the volatility assumption was based on the review of volatility statistics of peer banks.

Dividend yield - Due to dividend restrictions early in the life of the Bank and the anticipated need for capital to fund growth, management assumes that no dividends will be paid over the expected life of options granted.

Expected life - The expected life is assumed to be 75% of the contractual life of the option. This is based on a review of average life assumptions used by seasoned community banks that base their average life assumptions on actual historical exercise statistics.

The following table summarizes the weighted average assumptions used by the Black-Scholes option-pricing model stock and other information concerning stock option awards granted by the Bank as of and for the years ended December 31, 2013 and 2012.

	2013	**2012**
Weighted average risk-free interest rate	**2.27%**	-
Expected volatility	**30%**	-
Expected life (years)	**7.5 years**	-
Dividend yield	**None**	-
Compensation charged against pretax income	**$ 95,736**	$181,372
Approximate future compensation of options outstanding	**$182,000**	$191,000
Weighted average years remaining to recognize future compensation	**2.6 years**	2.4 years

Director Compensation Program - In 2012, the Bank adopted a compensation plan for its 14 independent directors. Monthly fees earned by the directors are determined based on a combination of fixed amounts for board and committee membership, and variable amounts based on the number of meetings attended. The program was effective June 1, 2012, and total fee expense was approximately $152,000 and $86,000 in the years ended December 31, 2013 and 2012, respectively.

Directors may elect payment of fees in the form of cash or in Bank stock. Fees earned and payable in cash are paid quarterly, and fees payable in Bank stock are accrued monthly based on the market price of the stock on the last day of each respective month. The accrued compensation is settled from authorized but unissued shares semi-annually. Stock-settled fees earned and accrued in the year ended December 31, 2013 were $110,352, or 10,900 shares, of which 5,535 shares were issued in January 2014. The total of stock-settled fees earned and accrued in the year ended December 31, 2012 was $60,995, or 6,594 shares, which were issued in January 2013.

NOTE 14 - REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking regulatory agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification also are subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets and of Tier 1 capital to average assets. As of December 31, 2013, the most recent notification from the Bank's primary regulator categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events that management believes have changed the Bank's category.

The following table summarizes the capital amounts and ratios of the Bank and the regulatory minimum requirements at December 31, 2013 and 2012:

	Actual		For Capital Adequacy Purposes Minimum		To be Well Capitalized Under Prompt Corrective Action Provisions Minimum	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
			(Amounts in $000)			
As of December 31, 2013:						
Total capital						
(To risk weighted assets)	**$ 33,586**	**16.9%**	**$ 15,920**	**8.0%**	**$ 19,900**	**10.0%**
Tier 1 capital						
(To risk weighted assets)	**31,086**	**15.6**	**7,960**	**4.0**	**11,940**	**6.0**
Tier 1 capital						
(To average assets)	**31,086**	**12.6**	**9,863**	**4.0**	**12,329**	**5.0**
As of December 31, 2012:						
Total capital						
(To risk weighted assets)	$ 32,851	17.3%	$ 15,220	8.0%	$ 19,026	10.0%
Tier 1 capital						
(To risk weighted assets)	30,464	16.0	7,610	4.0	11,415	6.0
Tier 1 capital						
(To average assets)	30,464	12.3	9,922	4.0	12,402	5.0

NOTE 15 - RELATED PARTY TRANSACTIONS

Certain directors, executive officers and companies with which they are affiliated (collectively referred to as “insiders”) are customers of and have banking transactions with the Bank in the ordinary course of business. Loans to insiders are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable arms-length transactions. At December 31, 2013 and 2012, respectively, loans to insiders approximated $10.3 million and $7.2 million, and deposits from insiders approximated $8.0 million and $9.2 million.

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments include cash and due from banks, federal funds sold, investment securities, other investments, loans, deposit accounts, other borrowings, and accrued interest. The following methods and assumptions were used by the Bank in estimating fair values of financial instruments recorded or disclosed in the financial statements:

Cash and Due from Banks - For these short-term instruments, the carrying amounts approximate their fair values.

Federal Funds Sold and Interest Bearing Bank Balances - The carrying amounts of federal funds sold and interest bearing bank balances approximate their fair value due to their short maturities (daily).

Bank Term Deposits - Fair values for fixed-rate certificates of deposit are estimated utilizing a discounted cash flow calculation that applies current market interest rates of certificates of deposits with similar remaining maturities to the portfolio of certificates of deposits.

Investment Securities - Fair value for investment securities equals quoted market price if such information is available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities. The Bank utilizes a third party pricing service to provide valuations on its securities portfolio. Most of these securities are U.S. government agency debt obligations or agency mortgage-backed securities traded in active markets. The third party valuations are determined based on the characteristics of each security (such as maturity, duration, rating, etc.) and in reference to similar or comparable securities. Due to the nature and methodology of these valuations, the Bank considers these fair value measurements as Level 2.

Other Investments - No ready market exists for the FHLB stock, and it has no quoted market value. However, redemption of the stock historically has been at par value; therefore, it is stated at the Bank’s cost basis.

Loans - For variable rate loans that reprice based on each change in a reference rate (e.g. prime rate), fair values are based on carrying values. Fair values for all other loans are estimated using discounted cash flow analyses, with interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for impaired loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Accrued Interest Receivable and Payable - The carrying amounts for these items approximate their fair values due to the short period to settlement (three months or less).

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Deposits - The fair values disclosed for demand deposits are, by definition, equal to their carrying amounts. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated monthly maturities.

Securities Sold Under Agreements to Repurchase - The carrying value of these retail repurchase agreements approximates fair value since these obligations mature daily.

Advances from FHLB of Atlanta - The valuation methodology utilizes a discounted cash flow calculation that applies current offered interest rates for fixed rate advances with similar remaining maturities.

Off-Balance Sheet Instruments - Fair values of off-balance sheet lending commitments 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. The total fair value of such instruments is not material.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Bank's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Bank's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and, therefore, cannot be determined with precision. Changes in assumptions could affect these estimates significantly.

The estimated fair values of the Bank's financial instruments were as follows at December 31, 2013 and 2012:

	2013		**2012**	
	Carrying Amount	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial Assets:				
Cash and due from banks	**$ 5,692,846**	**$ 5,692,846**	$ 7,209,287	$ 7,209,287
Federal funds sold and interest bearing bank balances	**855,115**	**855,115**	7,852,117	7,852,117
Bank term deposits	**6,723,000**	**6,718,197**	4,980,000	4,992,166
Investment securities, available for sale	**44,547,635**	**44,547,635**	46,902,315	46,902,315
Other investments	**389,000**	**389,000**	448,400	448,400
Loans, net	**179,330,714**	**180,724,844**	172,283,554	173,731,565
Accrued interest receivable	**705,547**	**705,547**	693,078	693,078
Financial Liabilities:				
Deposits	**203,499,827**	**199,902,717**	209,353,951	207,695,154
Securities sold under agreements to repurchase	**10,142,253**	**10,142,253**	5,311,528	5,311,528
Advances from FHLB of Atlanta	**1,000,000**	**1,020,357**	2,000,000	2,068,036
Accrued interest payable	**44,428**	**44,428**	60,537	60,537

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The Bank reports fair value on a recurring basis for certain financial instruments, most notably available for sale investment securities. The table below presents the balances of assets and liabilities measured at fair value on a recurring basis:

	Total	Level 1	Level 2	Level 3
December 31, 2013:				
Investment securities, available for sale:				
U.S. government agency and sponsored enterprises	**$10,595,096**	**$ -**	**$10,595,096**	**$ -**
Agency mortgage-backed securities	**18,633,535**	**-**	**18,633,535**	**-**
Agency collateralized mortgage obligations	**6,285,622**	**-**	**6,285,622**	**-**
Municipal securities	**9,033,382**	**-**	**9,033,382**	**-**
Total	**$44,547,635**	**$ -**	**$44,547,635**	**$ -**
December 31, 2012:				
Investment securities, available for sale:				
U.S. government agency and sponsored enterprises	$ 5,229,331	$ -	$ 5,229,331	$ -
Agency mortgage-backed securities	26,948,485	-	26,948,485	-
Agency collateralized mortgage obligations	8,005,221	-	8,005,221	-
Municipal Securities	6,719,278	-	6,719,278	-
Total	$46,902,315	$ -	$46,902,315	$ -

The Bank may be required, from time to time, to measure certain assets at fair value on a non-recurring basis. These include assets that are measured at the lower of cost or market that were recognized at fair value which was below cost at the end of the period. Assets subject to non-recurring use of fair value measurements include impaired loans and foreclosed assets. Due to the use of both observable and unobservable inputs and the significant amount of judgment required in the determination of fair values, both of these categories of assets are considered to be valued under Level 3 inputs.

The fair value of impaired loans is determined based upon the present value of expected cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral-dependent. The fair value of collateral is determined by obtaining an observable market price or obtaining an appraised value from an independent licensed or certified appraiser, using observable market data. This data includes information such as selling price of similar properties and capitalization rates of similar properties sold within the market, adjusted for differences in the properties, expected future cash flows, or earnings of the subject property based on current market expectations and other relevant factors. In addition, management may apply selling and other discounts to the underlying collateral value to determine the fair value.

Other real estate owned is valued by use of appraisals and management's judgment as described for valuation of collateral underlying collateral-dependent impaired loans.

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The following tables present the fair value measurement of assets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2013 and 2012:

	Total	Level 1	Level 2	Level 3
December 31, 2013:				
Impaired loans	**$ 5,391,288**	**$ -**	**$ -**	**$ 5,391,288**
Other real estate owned	**1,108,731**	**-**	**-**	**1,108,731**
Total	**$ 6,500,019**	**$ -**	**$ -**	**$ 6,500,019**
December 31, 2012:				
Impaired loans	$ 5,479,998	$ -	$ -	$ 5,479,998
Other real estate owned	797,658	-	-	797,658
Repossessed collateral	102,427	-	-	102,427
Total	$ 6,380,083	$ -	$ -	$ 6,380,083

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of December 31, 2013, the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value	Valuation Technique	Significant Unobservable Inputs
Impaired loans	**$ 5,391,288**	Appraised Value, Discounted Cash Flows and Market Value of the Underlying Collateral	Discount Factors Applied to Valuations for: Shorter Marketing Period (Liquidation Approach), Sales Commissions, and Selling Costs
Other real estate owned	**1,108,731**	Appraised Value and Estimates from Independent Sources	Discount Factors Applied to Valuations for: Shorter Marketing Period (Liquidation Approach), Sales Commissions, and Selling Costs
Total	**$ 6,500,019**		

NOTE 17 – PROPOSED MERGER WITH FOREST COMMERCIAL BANK

On August 7, 2013, the Bank entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Forest Commercial Bank, a North Carolina state-chartered bank with its principal office in Asheville, North Carolina (“Forest Commercial”). Pursuant to the Merger Agreement, Forest Commercial will merge with and into the Bank. Under terms of the Merger Agreement, each outstanding share of the common stock of Forest Commercial will be exchanged for 0.755 shares of Carolina Alliance common stock. Cash will be paid in lieu of fractional shares. After the merger, Carolina Alliance’s existing shareholders will own approximately 58% of the total shares outstanding, on a fully diluted basis, and Forest Commercial’s shareholders will own approximately 42% of Carolina Alliance’s outstanding shares on a fully diluted basis.

At December 31, 2013, Forest Commercial had total assets of $175.2 million, gross loans of $119.8 million, deposits of $145.4 million, and shareholders’ equity of $18.9 million. Also, as of December 31, 2013, Forest Commercial had a total risk-based capital ratio of 15.51%, a Tier 1 risk-based capital ratio of 14.27%, and a leverage ratio of 10.45%; Forest Commercial was considered “well-capitalized” for regulatory capital purposes.

The merger is subject to the approval of the FDIC, the South Carolina Board of Financial Institutions, the North Carolina Commissioner of Banks, and the North Carolina State Banking Commission. The merger was approved by the FDIC on March 11, 2014. The merger also was subject to the approval of the holders of two-thirds of the outstanding shares of Carolina Alliance’s common stock and the holders of a majority of the outstanding shares of Forest Commercial’s common stock. The merger was approved by both banks’ shareholders at special meetings of CAB shareholders and FCB shareholders, held on December 16, 2013 and December 10, 2013, respectively. Closing of the transaction is expected to occur early in the second quarter of 2014.

If either party terminates the merger agreement by reason of the other party’s material breach of its representations, warranties and/or covenants in the merger agreement, the parties agree that the party in breach shall pay $250,000 as liquidated damages to the non-breaching party. If the merger is not consummated under certain other specific circumstances, Forest Commercial has agreed to pay Carolina Alliance a termination fee of $700,000.

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Annual Meeting
May 18, 2012 at 10:00 am
Carolina Alliance Bank
Third Floor
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Carolina Alliance Bank stock is quoted on the OTC Bulletin Board (www.otcbb.com) and the OTCQB segment of OTC Markets (www.otcmarkets.com) under the symbol CRLN

This statement has not been reviewed, or confirmed for accuracy or relevance, by the Federal Deposit Insurance Corporation.